

# **SANTA CLARA COUNTY ASSESSMENT PRACTICES SURVEY**

**SEPTEMBER 1998**

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## **CALIFORNIA STATE BOARD OF EQUALIZATION**

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E. L. SORENSEN, JR., EXECUTIVE DIRECTOR



## FOREWORD

The county assessor is responsible for the assessment of all taxable property within the county, except state-assessed property. The assessor's responsibilities include such things as (1) discovering and taking inventory of all property within the county, (2) determining a property's eligibility for a full or partial exemption from assessment, (3) determining the proper assessee who is usually but not always the owner, (4) determining the location for assessment purposes of the property, and (5) determining the taxable value of the property in accordance with California property tax law.

Determining taxable value is usually the most difficult and subjective of the assessor's duties. In addition to the inherently subjective nature of the appraisal process, the assessor also has to determine whether the taxable value is to be based on current fair market value or on a value base set earlier. When there is construction activity on a property, the assessor has to determine whether the construction is to be assessed or whether it is excluded from assessment under the law. When there is an ownership transaction, the assessor has to determine whether the law requires a reassessment of the property or whether the property must continue to be assessed according to the existing value base.

The factors discussed above, as well as others not mentioned here, contribute to making local property tax assessment a difficult tax program to administer. It is also a very important program since the property tax is one of the most important sources of revenue for local governments and public schools. For property owners it is a major annual tax burden, and, since it is normally paid in one or two large installments rather than many small increments, it tends to be more visible than most other taxes. Accordingly, proper administration of the property tax assessment program is vitally important both to the public agencies that rely on the tax and to the people who have to pay the tax.

Although the primary responsibility for local property tax assessment is a function of county government, the State Board of Equalization has a number of duties in the property tax field imposed by the State Constitution and the Legislature. One of these duties, performed by the Board's County Property Tax Division, is to conduct periodic surveys of local assessment practices and report the findings and recommendations that result from the survey. The surveys may include a sampling of assessments of the local assessment roll, and they must include research in the assessor's office to determine the adequacy of the procedures and practices employed by the assessor in the assessment of taxable property, compliance with state law and regulations, and other required duties.

The assessor was provided a draft of this report and given an opportunity to file a written response to the recommendations and other findings contained in the report. This report, together with the county assessor's response and the Board's comments regarding the response, constitute the final survey report which is distributed to the Governor, the Attorney General, both houses of the State Legislature; and the county's Board of Supervisors, Grand Jury, and Assessment Appeals Board.

Nearly all of the fieldwork for this survey report of the Santa Clara County Assessor's Office was completed by County Property Tax Division staff during the period from

October 1996 through March of 1997. This report does not reflect changes implemented by the assessor after that field work was completed. Additional fieldwork was performed in mid-1998 to review assessments of computer software.

The Honorable Lawrence E. Stone, Santa Clara County Assessor, and his staff gave us their complete cooperation during the assessment practices survey. We gratefully acknowledge their patience and good spirit during the interruption of their normal work routine.

William B. Jackson, Chief  
County Property Tax Division  
Department of Property Taxes  
California State Board of Equalization  
September 1998

## COUNTY PROPERTY TAX DIVISION SURVEY GROUP

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## I. INTRODUCTION, SUMMARY, RECOMMENDATIONS, AND SUGGESTIONS

### A. INTRODUCTION

Subdivision (a) of section 15640 of the Government Code in part mandates that:

"The State Board of Equalization shall make surveys in each county and city and county to determine the adequacy of the procedures and practices employed by the county assessor in the valuation of property for the purposes of taxation and in the performance generally of the duties enjoined upon him or her. "

In addition, subdivision (c) provides that:

"The surveys may include a sampling of assessments from the local assessment rolls. Any sampling conducted pursuant to subdivision (b) of section 15643 shall be sufficient in size and dispersion to insure an adequate representation therein of the several classes of property throughout the county."

It is apparent from this language that the Legislature envisioned the County Property Tax Division's (CPTD) assessment sampling and office survey to be integral components of a unified process, i.e., the evaluation of how well the county assessor is carrying out the sworn duty to assess all taxable property on the local tax roll. This evaluation was to be based both on actual field appraisals of sampled roll items and in-office interviews and research.

Government Code section 15640 subdivision (f) also provides that:

"The board shall develop procedures to carry out its duties under this section after consultation with the California Assessors' Association. The board shall also provide a right to each county to appeal to the board appraisals made within his or her county where differences have not been resolved before completion of a field review and shall adopt procedures to implement the appeal process."

The way in which the sampling and office survey process is carried out was developed after consultation with county assessors by the staff of the County Property Tax Division.

This report is the culmination of a review of the Santa Clara County Assessor's operation including CPTD staff's appraisals of properties selected on the basis of assessment category and assessed value. The survey team analyzed the results of the assessment sampling and examined current practices and procedures in key areas to identify significant problems in

the assessor's operation. Finally, the survey team developed positive courses of action, presented here as recommendations and suggestions, to help the assessor resolve problems identified in his program.

## B. SAMPLING RESULTS

CPTD's field appraisal team completed appraisals of 328 properties of all types assessed on the 1996-97 Santa Clara County assessment roll. This roll contained a total of 490,828 assessments having a total taxable value of \$120,232,223,223. (For a detailed explanation of CPTD's appraisal sampling program, see Appendix A.) The results of the sampling indicated the composition of the roll by property type as follows:<sup>1</sup>

<b>Property Type</b>	<b>No. of Assessments In County</b>	<b>Enrolled Value</b>
<i>Residential</i>	401,302	\$70,995,121,291
<i>Rural</i>	5,969	\$434,698,187
<i>Commercial/Industrial</i>	67,460	\$46,853,314,847
<i>Miscellaneous</i>	16,097	\$1,949,088,898
<b>Total</b>	<b>490,828</b>	<b>\$120,232,223,223</b>

## C. SUMMARY

Section 75.60 of the Revenue and Taxation Code<sup>2</sup> requires that the Board of Equalization (Board) certify that a county is eligible to recover the administrative costs of processing supplemental assessments. To be certified as eligible, the county must meet both of the following requirements of section 75.60 (b) (2):

(A) The average assessment level in the county or city and county is at least 95 percent of the assessment level required by statute, as determined by the board's most recent survey of that county or city and county performed pursuant to section 15640 of the Government Code.

(B) For any survey of a county assessment roll for the 1996-97 fiscal year and each year thereafter, the sum of the absolute values of the differences from the statutorily required assessment level described in subparagraph (A) does not exceed 7.5 percent of the total amount of the county's or city and county's statutory required assessed values, as determined pursuant to the board's survey described in subparagraph (A).

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<sup>1</sup> This information provided by the Board's Agency Planning and Research Division, Statistics Section.

<sup>2</sup> All statutory references are to the Revenue and Taxation Code unless otherwise indicated.



The recent survey shows that the average assessment level is 98.6 percent and the absolute difference from the statutorily required assessment level described in subparagraph (A) is 2.57 percent. Based on CPTD's sampling its 1996-97 roll, Santa Clara County is eligible for reimbursement of costs associated with administering supplemental assessments. Based on this data, the assessor's program meets the requirements of section 75.60.

Major changes have occurred within the Santa Clara Assessor's Office since our last survey report of October 1995. The assessor has encouraged his board of supervisors to participate in the newly created State-County Property Tax Administration Program (AB 818). With a substantial state loan provided by this program, the assessor updated the current in-house computer, acquired a Local Area Network with personal computers (PC) for the real property division, completely renovated the real property division's work area, and created a real property crew of newly hired staff to address the backlog of change in ownership and new construction. This has substantially improved the assessor's operation in addressing both the increased assessment appeals workload and the backlog of assessable new construction and changes in ownership.

The assessor and the assessment appeals board solicited suggestions from private industry on how to eliminate the backlog of assessment appeals cases and develop new procedures to eliminate problems within the system. The result was a simplified and streamlined assessment appeals process.

In 1995 at the request of the assessor, the board of supervisors adopted an ordinance that exempted from taxation business property under \$2,000 in value. We commend the assessor for pursuing this ordinance; however, we suggest that he request expansion of the ordinance to include real property and an increase in the value limitation to the maximum allowed by statute (\$5,000).

More recently, during our survey fieldwork, the Santa Clara County Board of Supervisors, again on the assessor's recommendation, enacted a general disaster relief ordinance pursuant to section 170. The program appears to be treating reported damaged properties appropriately; however, we suggest that the assessor improve the discovery procedures for these types of property.

The organization of the real property division provides excellent coverage of the county. Appraisal crews have geographic areas of responsibility. However, a single appraisal unit appraises complex, or specialized, properties throughout the county, and a single unit handles single-family residential assessment appeals. The staff are highly motivated, competent, and professional. A very competent management team oversees the total program.

There was a backlog of unworked transfers due to the priority placed on assessment appeal. During the time of our fieldwork, the office reduced the backlog by 90 percent.

The change in ownership program is very well run. It is efficient and the processing of the deeds is very complete. In order to make appropriate cash equivalent adjustments to the nominal sales price, we suggest that the assessor obtain up-to-date bond information from the county tax collector's and auditor-controller's offices.

The new construction program is well managed except for the backlog in assessing new construction due to the priority placed on assessment appeals. We urge the staff to eliminate the backlog and keep current on all new construction. In addition, we suggest that the staff maintain a list of culled permits as a means of reviewing for cumulative construction on a property.

The Santa Clara County Assessor's Office was among the few county assessors' offices that proactively reduced residential property values on a mass appraisal basis, reflecting the downward trend in property values during the early 1990's. As market values started to rebound in 1995-96, the assessor's office was the first office to recognize this positive market growth, restoring values fully or partially for the 1996 roll. An analysis of sales indicates that high school boundaries proved to be the most reliable and recognizable demographic indicator for restoring values on residential properties.

Declines in value of commercial and industrial properties were made on a case-by-case basis. However, in recognition of the recent market growth, the assessor's office adjusted their values by the Board-announced inflation factor without adequate market analysis. We recommend that the assessor justify any adjustments with a market study.

Property subject to the California Land Conservation Act (CLCA) is not a significant part of the local roll but deserves uniform treatment. Our recommendation from the prior report to attribute value to trees and vines and use the animal unit month measurement has not been followed and is repeated. In addition, we recommend that the program include the comparison of the market value and restricted value to determine taxable value. We also recommend the incorporation of a component in the capitalization rate for nonliving improvements and wells. This program should also include a one-time complete field review of all CLCA properties to ensure accuracy of records. In addition to CLCA properties, other rural property records need better documentation as to value and description.

We have minor comments regarding the assessment of property owned by a local municipality but located outside their boundaries.

The possessory interest program has been revised to include a review of properties owned by public retirement systems in the county. The staff contacts all public agencies to obtain information on possessory interests, and their records are very well documented. We commend the assessor for revising this program to address a concern raised in our prior report.

The assessor has attempted to identify and assess all private water companies. However, the staff is not using all valuation approaches and has not timely reappraised the real property of a transferred private water company.

The business property assessment program is one of the best we have reviewed. It is staffed by competent and professional auditor-appraisers and well managed by a competent management team. The mandatory audit program is comprehensive and efficient. Audits are completed timely and with the exception of documenting the assessment of basic operational computer programs, the quality is good. Waivers are obtained when necessary. There is a team concept for appraising the largest properties. However, we do have some recommendations for further upgrading the program

The audit program is a good program. There is an adequate tracking system to ensure that mandatory audits are completed timely, and the program includes a complete review of all audits. One suggestion we do make is to expand the nonmandatory audit program to, among other things, insure proper reporting on business property statements.

The processing of business property statements is well managed. A division-wide meeting is held prior to the start of the processing season to prepare the staff for this annual workload. Procedures and guidelines are reviewed with the staff. Despite this preparation, there are still problems with inconsistent use of index factors within similar business types, and agent signatures are sometimes accepted without confirmation. We also recommend increased purging of old data from business property files to deal with the storage space problem.

The assessor changed his discovery program for business property this year. Instead of depending mainly on a field canvas, he now uses the Board's sales tax permit cards. This appears to be a more efficient system. For example, it should reduce costs by reducing the need for data collectors.

The assessor has a limited direct enrollment program for business property. We suggest that he expand the program as a way to reduce taxpayer paperwork and make more efficient use of his auditor-appraisers.

In the prior report, we recommended that the assessor's staff use appropriate index factors when valuing business property. The assessor has not made this change. We repeat the recommendation, and we also recommend that staff maintain consistency in using percent good factors.

We have several recommendations for improving the assessment procedures of specific types of business property. Apartment personalty assessment should be based on information from the taxpayers, rather than an arbitrary assessment. We repeat our recommendation to uniformly assess leasehold improvements; and we urge the assessor to improve the coordination between the business and real property divisions. Boat and vessel assessments have not been revised as recommended in our prior report. However, the assessor has taken steps to access the Department of Motor Vehicle boat database.

The assessor has been very active in the development of valuation factors for computers. He was part of a task force consisting of representatives from industry, the Board, and assessors that studied and developed valuation factors for computers. There was disagreement

between the Board and the assessors about the correct 1996 factors to use for mid-range computers; however, we were assured by staff that the Board factors would be used for the 1997-98 assessment roll.

Finally, we recommend that the assessor revise the procedure for assessing basic operational computer programs to ensure that non-taxable application computer programs are not assessed.

#### D. RECOMMENDATIONS AND SUGGESTIONS

Following are the recommendations and suggestions contained in this report. They are listed in the order they appear in the report along with the page number on which they can be found.

##### **RECOMMENDATIONS**

- RECOMMENDATION 1: Obtain bond information from the tax collector's and auditor-controller's offices. (Page 26)
- RECOMMENDATION 2: Adjust taxable values only when the change can be supported from market data. (Page 30)
- RECOMMENDATION 3: Revise the CLCA program by: (1) assessing trees and vines; (2) using animal unit months (AUM's) as the unit of measurement in assessing grazing land; (3) deducting a charge from the income stream for return on and of investment in nonliving improvements; (4) deducting a capital replacement charge for irrigation wells; and (5) incorporating the current market value test for determining taxable value. (Page 32)
- RECOMMENDATION 4: Properly assess all properties subject to the provisions of article XIII, section 11 of the California Constitution. (Page 36)
- RECOMMENDATION 5: Develop historical cost less depreciation and capitalized income value indicators for all private water companies; reappraise the transferred private water company. (Page 39)
- RECOMMENDATION 6: Improve the processing of business property statements by: (1) using the Board's equipment index and percent good factors as recommended in the AH 581; (2) applying the equipment index factors uniformly within similar business types; (3) screening the property statements for authorized signatures; and (4) ) following the policy to purge old data from business property files. (Page 46)

- RECOMMENDATION 7: Revise the assessment of personal property in apartments by: (1) basing the assessment on information provided on the apartment house property statements; and (2) correctly applying the low-value ordinance. (Page 53)
- RECOMMENDATION 8: Revise the assessment of leasehold improvements by: (1) improving the response system to ensure coordination between the business and real property divisions; and (2) ensuring that all leasehold improvements are treated uniformly. (Page 56)
- RECOMMENDATION 9: Revise boat appraisal procedures by appraising pleasure boats at market value. (Page 58)
- RECOMMENDATION 10: Revise the procedures for assessing computer programs by (1) assessing only basic operational programs; (2) establishing criteria for assessing computer software; and (3) explaining in the audit narrative and other workpapers the basis for assessing basic operational programs. (Page 61)

### **SUGGESTIONS**

- SUGGESTION 1: Improve the low-value property exemption program by requesting that the present ordinance be amended: (1) to include all classes of property; and (2) to reflect current exemption limits. (Page 20)
- SUGGESTION 2: Use additional sources to discover property that has suffered a decline in taxable value because of misfortune or calamity. (Page 22)
- SUGGESTION 3: Maintain a list of discarded building permits and periodically review the list for construction that might accumulate to an assessable level. (Page 28)
- SUGGESTION 4: Improve the California Land Conservation Act (CLCA) program by field reviewing all CLCA properties. (Page 34)
- SUGGESTION 5: Increase documentation on appraisal records. (Page 35)
- SUGGESTION 6: Update and formalize the business property division's policy and procedures manual. (Page 41)
- SUGGESTION 7: Request additional staff positions to expand the nonmandatory audit program. (Page 44)
- SUGGESTION 8: Expand the direct billing program. (Page 50)

SUGGESTION 9: Revise the leased equipment assessments by: (1) annually reviewing the Board's listing of property leased to state assessees; and (2) ensuring that leased equipment retained by the lessee when the lease expires continues to be assessed. (Page 51)

SUGGESTION 10: Redirect nonappraisal duties to the support staff. (Page 59)

## II. ADMINISTRATION

### A. BUDGET, WORKLOAD, AND STAFFING

The County of Santa Clara is redesigning its management program around a concept called Comprehensive Performance Management (CPM). The Santa Clara County Assessor has been a leader in program participation. All divisions of the assessor's office are actively engaged in developing a mission statement, establishing specific goals and performance objectives, and developing a system to monitor performance and productivity. The goal is to provide the highest quality customer service at all times. CPM will help the assessor's office staff operate in a new government environment focused on consumer friendly customer service.

For 1995-1996, the Santa Clara County Assessor's Office prepared a roll containing 427,126 secured assessments and 89,137 unsecured assessments with an approved budget of \$14,860,526 (\$445,194, or 3 percent less than the prior year). The budget approved for the 1996-97 fiscal year was \$15,171,494. This budget funded 250 permanent positions (the same number of positions as the year before). The property tax revenues for 1996-97 totaled about \$1.3 billion.

The decision to participate in the State-County Property Tax Administration Program (known as AB 818 after the assembly bill that created the program) allowed the Santa Clara County Assessor to improve and upgrade assessment capabilities. The assessor's office received over \$4.2 million from this program. In addition to funds for increased staffing, some of the state funds went to modify, upgrade, and reconfigure assessment technology. Almost \$1.8 million has been allocated to the hiring of appraisal staff. At the time of our survey fieldwork, ten senior appraisers and three appraiser IIs were added to the staff on a temporary or unclassified civil service basis. This staff is assigned to eliminate the backlog of assessable changes in ownership and new construction.

We analyzed the workload and staff size of the Santa Clara Assessor's Office by relying primarily on A Report on Budgets, Workloads, and Assessment Appeals Activities in California Assessors' Offices, 1994-1995 that was dated May, 1996 and issued by the California State Board of Equalization. This is a compilation and analysis of data gathered by the Board's Policy, Planning, and Standards Division from a questionnaire sent to all assessors. Based on our knowledge of assessor's offices through the assessment practices survey program, we selected counties considered comparable to Santa Clara in one or more important ways and compared their workload, staffing, and budgeting figures to those of Santa Clara County.

We caution the reader that the data used for this illustration does not incorporate statistics resulting from additions to professional, technical, and clerical staff made possible by funding under AB 818. At the time of our survey fieldwork, assessor's staff reported, and we noted, significant changes, not only in the operations of the assessor's office, but also in the physical appraisal plant as well. Almost all changes resulting from this new funding occurred after the May, 1996 publication of A Report on Budgets, Workloads, and Assessment Appeals

Activities in California Assessors' Offices, 1994-1995. Data resulting from the additional personnel, and the purchase and installation of modernizing equipment and technologies has not been solicited, assembled, or arrayed for comparison or analysis at this time. This funding is discussed elsewhere in this report.

We further caution the reader that we are not assuming that the staffing of the comparable counties is adequate or proper. In fact, in some instances it is evident that recent budget and staffing reductions in the comparable counties have severely strained the capabilities of those assessors to maintain an acceptable level of quality in their assessment programs. However, we believe the comparisons illustrate the minimum staffing necessary to operate a large urban county in substantial compliance with the numerous laws and regulations that govern that function.

# 1. Budget and Roll Value

The first area of comparison we made was in total budget roll units and roll value. This was done to establish an overview of the total assessment workload.

CHART I  
TOTAL BUDGET, ROLL UNITS AND ROLL VALUE COMPARISON, 1994-95

County	Total Staff	Total Budget (in millions)	Total Roll Units	Total Roll Value (in billions)	Budget Per Staff	Roll Units Per Staff	Roll Value Per Staff (in thousands)
Alameda	183.6	\$ 9.82	443,412	\$ 79.2	\$53,485	2,415	\$431,372
Contra Costa	129.8	\$ 7.92	358,927	\$ 65.3	\$61,016	2,765	\$503,081
Sacramento	150.5	\$ 9.60	446,320	\$ 53.5	\$63,787	2,965	\$355,481
<b>AVERAGE</b>					<b>\$58,935</b>	<b>2,691</b>	<b>\$426,816</b>
<b>Santa Clara</b>	<b>262.4</b>	<b>\$15.49</b>	<b>516,077</b>	<b>\$114.9</b>	<b>\$59,032</b>	<b>1,966</b>	<b>\$437,881</b>

# 2. Workload

We included in Chart II those elements that we considered relevant to the real property appraisal staff, and in Chart III we included those we considered relevant to the business property staff. Other items are also worked by the appraisal staff (such as value declines, assessment reviews, appeals), but due to reporting problems and wide annual fluctuations, these items were not included.



CHART II  
REAL PROPERTY WORKLOAD COMPARISON

County	Real Property Appraiser	Secured Roll Units	Total Transfers	New Construction Units (NC) Appraised	Secured Roll Units Per Appraiser	Transfers Per Appraiser	New Construction Per Appraiser
Alameda	59	384,257	27,106	5,930	6,513	459	100
Contra Costa	50.4	298,275	20,135	2,113	5,918	400	41
Sacramento	60	372,370	26,391	7,378	6,206	440	122
San Mateo	42	212,743	22,905	4,501	5,065	545	107
<b>AVERAGE</b>					<b>5,996</b>	<b>456</b>	<b>94</b>
<b>Santa Clara</b>	<b>74</b>	<b>426,940</b>	<b>26,039</b>	<b>11,226</b>	<b>5,769</b>	<b>351</b>	<b>151</b>

CHART III  
BUSINESS PROPERTY WORKLOAD COMPARISON

County	Business Property Appraiser	Business Property Assessments	Assessments Per Business Property Appraiser	Mandatory Audits Due	Mandatory Audits Per Appraiser	Property Statements Total	Property Statements Per Appraiser
Alameda	27	57,473	2,128	499	18	34,808	1,289
Contra Costa	12	52,443	4,370	288	24	25,358	2,113
Sacramento	20	64,814	3,240	310	15.5	32,913	1,645
San Mateo	11	33,733	3,066	264	24	22,004	2,000
<b>AVERAGE</b>			<b>2,978</b>		<b>19.4</b>		<b>1,664</b>
<b>Santa Clara</b>	<b>41</b>	<b>89,135</b>	<b>2,174</b>	<b>923</b>	<b>22</b>	<b>63,340</b>	<b>1,544</b>

**B. STATE-COUNTY PROPERTY TAX ADMINISTRATION PROGRAM**

Section 95.31 provides that, upon the recommendation of the assessor and by resolution of the county board of supervisors, the county may elect to participate in the State-County Property Tax Administration Program (more commonly called AB 818, after the assembly bill that created this program). A county may apply for a loan to enhance its property tax administration system, reduce backlogs of work, and maximize value enrollment capabilities. Most California counties participate in the program.

The county under contract may have the loan forgiven if performance measures are met. The improvement in these measures would, in theory, generate property tax revenue to schools greater than, or equal to, the loan amount.

In December 1995 the Santa Clara County Board of Supervisors, upon the recommendation of the assessor, elected to participate in the State-County Property Tax Administration Program for the period beginning with the 1995-96 roll year and ending June 30,

2000. Under the contract, the State agreed to loan \$4,213,639 for fiscal years 1995-96, 1996-97, and 1997-98. In exchange, the county agreed to use funds received from the State to enhance property tax administration, and not to use the loan to supplant the assessor's current level of funding. Santa Clara County agreed to maintain staffing and total funding levels equal to or exceeding those of the 1993-1994 fiscal year. For the initial loan, the assessor proposed allocations for personnel, system support staff, modernization of the computer system, and a modernization of the real property work area.

## 1. Systems and Physical Plant

The assessor allocated \$2.42 million of the \$4.2 million in AB 818 funds toward modernization and technical upgrades of the appraisal plant and recruitment of technical support personnel. The funding allowed the assessor to completely reconfigure and modernize the real property division's work area and to install a modern phone system. Modernization included rewiring for installation of a Local Area Network (LAN) and new cubicle partitioning. For further details, see the Technology section later in this report.

## 2. Personnel

The assessor allocated almost \$1.8 million to employ additional personnel to eliminate the backlog of assessable new construction and changes in ownership.

Between 1989 and 1996, filings of assessment appeals increased significantly due to declining economic conditions in Santa Clara County. Appraisal work on permitted new construction and changes in ownership in commercial and industrial properties accumulated for several years as appraisal staff concentrated on working assessment appeals cases that required resolution within a statutory time limit.

The same economic conditions that produced a general decline in property values likewise resulted in reduced need for appraisal services by institutions that once depended heavily on the appraisal profession. Appraisers, once in demand by lenders, financial institutions, and others suffered a reduced demand for their services in the current real estate market. Assessor's staff were aware of the qualified and experienced appraisers available for recruitment. They used this as an opportunity to assemble a team of temporary staff appraisers to address the problem of backlogged assessable new construction and changes in ownership.

The Department of Real Estate (DRE) was contacted and asked for a list of appraisers in the county who held a "general" certification. A number of them were invited to submit employment applications. Using hiring criteria weighted heavily toward appraisal education and work experience, staff selected the best candidates for temporary positions as senior appraisers, and then grouped the newly recruited appraisers into a special team called the "augmentation crew." This new team was assigned to the backlogged assessable new construction and changes in ownership in commercial and industrial real property.

To appraise for property tax purposes, the appraisers recruited for the augmentation crew were required to receive certification from the State Board of Equalization without delay. We noted that these conditions have been met, and this team of appraisers has effectively reduced the backlog of assessable transfers and new construction, thereby allowing regular staff appraisers to concentrate on assessment appeals.

### 3. Performance Measures

Each AB 818 contract contains the performance measures required to have the loan amount forgiven. Santa Clara County must report the actual workload, the number of reassessments completed, and the average increment of assessed value change. The assessor must specifically report the effective backlog of both permitted construction and changes in ownership. Both the reported figures and the calculations must be verified by the county's auditor-controller.

A loan will be considered repaid if the county is able to reduce its backlog of unworked permits and transfers so that its "percentage of success" exceeds 95 percent. This is computed by using the following formula that is stated in the agreement:

$$\frac{A + (B - C)}{A} \quad A = \text{The actual accumulated number of reassessments completed}$$

B = The backlog goal

C = The achieved backlog

For the period July 1, 1995 through October 8, 1996, the assessor reported a new construction workload of 33,232 units, of which 24,112 were completed. The net value change of reassessment worked was \$935,503,278, with an average increment of change of \$38,798. The specified contract goal was to leave no more than 11,680 items unworked. The actual remaining count of unworked items (achieved backlog) was 9,120.

For changes in ownership, the assessor reported an outstanding workload of 30,299. Staff worked 27,565 of these items with a net value change of \$2,453,820,356. The average increment of change is calculated to be \$89,019 per workload unit. The specified contract goal for changes in ownership was 3,000 backlogged items or less. The achieved backlog count reported was 2,734.

Under the contract terms, the assessor reported, and the auditor-controller verified by audit, that the "percentage of success," achieved two months ahead of contract schedule, was almost 106 percent.

The total added state and county revenue resulting from enrolling backlogged assessable events was estimated to be in excess of \$23,000,000. The newly hired "augmentation crew" has been used effectively in reducing the backlog of unworked assessable new

construction and changes in ownership. We commend the assessor for taking advantage of the State-County Property Tax Administration Program, and wisely using the funds for addressing the technological and physical plant needs of his office and resolving the large backlog of assessable new construction and transfers.

#### C. TRAINING PROGRAM

Section 670 provides that no person may perform the duties of an appraiser for property tax purposes unless he or she holds a valid certificate issued by the Board. Section 671 further provides that all appraisers shall complete at least 24 hours of training each fiscal year in order to maintain an appraiser's certificate, or 12 hours annually to maintain an advanced certificate.

The assessor regards training as a very high priority item. In reviewing training records kept by Board and the assessor, we noted no serious deficiencies. Further, the assessor's staff track training hours for all certified personnel and notify the division chiefs of individuals with training deficiencies. The county's assessment standards division keeps a list of approved courses and seminars in addition to Board courses and the appraisers who have requested them.

When certified employees receive training beyond the hours required by section 671, the excess hours may be carried forward to satisfy training requirements in following years. Many Santa Clara County appraisers and auditors carry significant numbers of surplus training hours that can be used in this way.

The assessment standards division logs all training for certified professional staff from commencement of employment to separation from the assessor's office. Training records include not only cumulative lists for all training courses, but also those who receive the initial permanent certification and the courses taken toward advanced certification.

Advanced certification reduces the annual training requirements from the 24 hours to 12 hours of training each year. About one-third of the real property appraisers and the auditor-appraisers have received the advanced certification.

Appraisers may elect to take courses delivered by professional organizations such as the Appraisal Institute. A number have done so, paying for the courses themselves, and receiving time to take them during working hours.

#### D. TECHNOLOGY

In our previous assessment practices survey, we noted that appraisers were able to access comparable sales data from the assessor's in-house mini computer. We also noted that the assessor's technical staff had developed a system for verifying, by regression analysis, information declared by purchasers of residential property and directly enrolling those transfers that fell within acceptable parameters. Staff held bi-weekly meetings to evaluate the effectiveness of existing programs and to discuss suggestions for how to refine the existing system to better

respond to the needs of the users. At that time, the technical staff were also developing a usable database of commercial and industrial properties and were in the process of assembling data for use in appraisal of income properties.

During our current fieldwork, we observed significant upgrades in the data processing capabilities and increased overall PC use by the assessor's staff. Some improvements were the result of ongoing changes, and, most dramatically, others were the result of AB 818 funding.

### AB 818 Funding

The Santa Clara County Assessor's Office entered into a contract with the State Department of Finance and received a loan in excess of \$4.2 million to enhance its assessment capabilities. The assessor allocated more than half of this amount to technology upgrades. Additional technical staff were recruited, bringing total technical staffing to 13 positions. The real property division appraisal plant, a third of the assessor's office, was gutted and reconfigured and a Local Area Network (LAN) was installed. All furniture and carpeting was replaced and new office cubicles and a modern telephone system were installed.

The assessor allocated \$300,000 to upgrade the existing in-house HP 3000 computer, and the system was improved through additions and replacements of hardware and software. The technical replacements and upgrades significantly improved the system's response time. In certain instances, an upgrade or replacement made possible by AB 818 funds resulted not only in improved speed of operation, but also in dramatically reduced contracted servicing costs. In some cases acquisition costs can be amortized within a year by these savings.

The assessor's office acquired 94 desktop Pentium P100 personal computers with Microsoft Office operating in the Windows 95 environment. Eighty-four of the newly acquired PC's were assigned to real property appraisal staff, and the other ten were kept for training purposes. The majority of the new PCs were acquired in September of 1996. By January of 1997 we observed staff appraisers processing assessment appeals using sales databases and sales comparison arrays to analyze and present commercial and industrial assessment appeals. And, where previously five appraisal staff members shared access to a given terminal, the ratio is now almost one-to-one.

Staff train in a newly dedicated computer training lab. The ten newly acquired PC's allocated for training are used for basic and intermediate classes in word processing, spreadsheets, and Windows 95. Professional instructors from the private sector were retained to provide comprehensive computer training to the staff.

Appraisers expressed enthusiasm for the increased accuracy, scope of analysis, and ease of data access now available. Response to modernization of the appraisal plant and the introduction of personal computers and the LAN was overwhelmingly positive. A significant proportion of the appraisal staff own their own personal computers, are already proficient in their use, and have developed analysis and Assessment Appeals Board presentation formats that are

available to other appraisers who have not yet gained proficiency in the development of these applications.

### Computer Systems

The assessor's office uses three types of computer systems. The county's IBM mainframe system is used by the business division, while most other assessor's office functions, including the real property division's needs, are served by the assessor's in-house HP 3000 mini computer system. The HP 3000 that currently has a 160 terminal capacity can be expanded to 200 terminals.

Personal computers (PC's) and terminals interface with the HP 3000 and are connected through a LAN which serves as the third system. Most PCs in use were recently acquired; and, at present, they are allocated mainly to the real property division. The business division will also acquire PCs that will be included in the existing LAN in the near future. Staff now use the LAN to access certain work template files as well as the Revenue and Taxation Code. Electronic mail (E-Mail) capabilities will be available in the near future.

The newly redesigned Assessor's Information Management System (AIMS) is accessed through the HP 3000. This centralizes all assessment information. The appraisal staff can access 259 information screens through AIMS. Real property data occupy 50 information screens, including a commercial/industrial property characteristics screen, bare land comparable search screen, an APN history screen, and a permit history screen. Rent comparables are input and arrayed in a format that is usable for valuation or preparation of assessment appeals. Using new database and extraction tools, the staff can create ad hoc reports as desired.

On-line information available for appraisers' use include a "COMPS" sales comparable service, Marshall Cost Estimator service, and CD-ROM access for Revenue and Taxation Code reference.

Computerized comparable sales searches have expanded from single-family residential comparables to include multi-family, commercial, and industrial properties. Single-family residential value trending is now tracked by school district as a refinement, and use of regression analysis has been expanded from its previous use to directly enrolling confirmed selling prices. Regression analysis is now also used to determine levels of value restoration for residential assessments that were previously lowered for decline in value.

### Mapping

The assessor's mapping section was computerized prior to the AB 818 funding. In May 1995, the assessor's office obtained Computer Assisted Drafting (CAD) software to draft new tracts and to make mapping changes by using overlays to erase portions of existing scanned maps. AutoCAD, the industry standard for CAD, was installed for drafting new maps, and Softdesk's CadOverlay is now used to make the needed changes caused by splits and combinations of parcels on existing maps. CAD use began with the 1996 roll year.

All mapping archive files, consisting of 11,285 maps, have been scanned and recorded on CD-ROM disks and are now accessible by personal computers with a CD ROM drive. While currently there is only a single copy of scanned maps on CD-ROM, staff plan to obtain graphic reader software so that a single dedicated PC, accessed through the LAN, will make the entire file of maps available to all staff. Staff appraisers will then be able to access and print individual block or area maps using their desktop personal computers.

The assessor and his staff changed the mapping process from a manual to an electronic mode for a number of reasons. First, all mapping technicians are now routinely educated in the use of computer assisted drafting. Secondly, the change eliminates the need for mylar drawings and the blue-line ammonia-based mapping reproduction equipment. Finally, all maps are now recorded, stored on a hard drive, and printed using laser printers. In making the changes, the mapping process was brought to present day industry standards.

### Planned Changes

The assessor plans to allocate the next year's AB 818 funds to meet the needs of the business division. The division's work area, like that of the real property division, will be upgraded and modernized. Planned improvements include extension of the LAN to include the business division and acquisition of 40 PC's for use by auditor-appraisers.

Staff are currently working to create a commercial and industrial database by combining data previously kept by individual appraisers. Such sales and income data, analyzed and verified by appraisers in the course of their appraisals, were kept separately and were not readily available to all staff appraisers. Consolidation of these separate verified and analyzed data should add substantially to the market data that is available to all staff.

The assessor's office also has a simplified AutoCAD program that can be used for drawing building footprints and calculating building areas. The office may incorporate this software in their cost approach program.

Some of the technological changes will result in new data that can be marketed to commercial interests. Staff are considering sales of the CD-ROM laser disks that contain a set of mapping archive files. These can be produced by the equipment that has been newly installed in the assessor's mapping section.

### **E. ASSESSMENT APPEALS**

Santa Clara County has two assessment appeals boards to handle the high volume of appeals. A hearing officer is also available to aid in determining assessment issues prior to valuation hearings before an assessment appeals board.

Assessment appeal filings have increased from 960 in 1989 to almost 7,000 in 1996. The assessment appeals workload in Santa Clara County increased rapidly in the last several years, almost doubling since our last assessment practices survey in 1995 from about

3,800 to 7,400 as of January 1997. Assessed values for all unworked appeals total over \$55.7 billion with applicants requesting reductions totaling \$25.6 billion or 20 percent of the total roll value. While sagging statewide, the economy was especially poor in Santa Clara County. Falling real estate values led to an unexpected number of “Proposition 8” appeals of declining values for all types of property.

To compound this problem, the clerk of the assessment appeals board did not have a fully staffed unit to deal with the increased volume of appeal applications. We noted in our previous survey report that this led to long delays in processing applications. The resulting delay added a significant period of time before the assessor received the appeal for processing.

At the time of our last survey, the previous assessor had already implemented several changes to reduce delays. An assessment appeals team was dedicated to work exclusively on single-family residential and 2-4 unit apartment appeals. Staff had enhanced the data processing system, first by establishing a comparable sales search mode for residential properties and second by creating an appeals database to track applications through the hearing process. The assessor’s office procured written waivers of the two-year limit for hearing appeals as provided by section 309 of Title 18 of the California Code of Regulations (Property Tax Rule 309). And finally, to deal with the increasing backlog of appeals cases in Santa Clara County, the previous assessor assigned assessment appeals the highest work priority. Appeals superseded reappraisals required by changes in ownership and new construction.

Subdivision (c) of section 1604 provides that:

If the county assessment appeals board fails to hear evidence and fails to make a final determination on the application for reduction in assessment of property within two years of the timely filing of the application, the taxpayer’s opinion of market value as reflected on the application for reduction in assessment shall be the value upon which taxes are to be levied for the tax year covered by the application.

The previous assessor made a decision to place statutory reassessments normally triggered by changes in ownership and assessable new construction in abeyance until the backlog of older appeals was reduced. And to help staff resolve assessment appeals within the prescribed two year period, he focused all available resources on reducing the appeals case backlog.

Despite these efforts, the backlog of unworked appeals cases increased due to continued real property value declines until mid-1995, when the commencement of an economic recovery resulted in both an increased demand for housing and recovering real property values. This decreased the number of new applications, but the backlog remained.

To deal with the backlog, the current assessor entered into a joint effort with the clerk of the Board of Supervisors and Joint Venture: Silicon Valley, a non-profit advisory council with volunteer consultants from private industry, to form the Assessment Appeals Streamlining



Review Committee to review the total appeals process. Together, they analyzed the assessment appeals process and recommended the following changes:

- generate a section 441(d) request letter from the assessor to all valid appeals applicants for commercial and industrial properties;
- simplify roll correction procedures to take full advantage of section 4831(b) in order to correct the roll prior to June 30, 1996;
- schedule a non-value hearing at the earliest opportunity for all not responding to the 441(d) request letter;
- use of standard pre-printed stipulation forms;
- upgrade technology capacity and physical facilities;
- establish a calendar of internal deadlines for the various stages of the appeal process;
- inform taxpayers of avenues other than the appeals process for resolving valuation issues;
- share data between agencies to avoid duplication of data entry;
- automate appeals application processing; and
- revise the assessment appeal application.

Implementation of these procedures has had a substantial effect on the timely resolution of appeals. In the past, about 55 percent of all appeals were resolved within 550 days. With implementation of the new procedures, completion of the 1995 appeals rose to 75 percent within 550 days. The assessor's staff projects an 85 percent case completion within the same 550 day period for appeals filed in 1996. It is anticipated that upon full implementation of the recommendations made by the Assessment Appeals Streamlining Review Committee, 90 percent of all assessment appeals filed in a given year will be resolved within 365 days of filing.

In particular we noted the following positive changes in the appeals program since the previous assessment practices survey:

1. Processing of Assessment Appeals Applications

Previously, the slow processing and transmission of appeals applications from the clerk of the board to the assessor consumed a substantial portion of the two-year statutory time period allowed by section 1604(c). The assessor was being notified almost 200 days after the board's receipt of assessment appeals filings. This greatly reduced the time available to the

assessor's staff to resolve appeals cases. The time lag is now 30 days in most cases, allowing the assessor's staff significantly more time to work the appeals.

## 2. Impact of Assembly Bill 818

We discussed the use of AB 818 funds in a previous part of this survey report. The real property division used the newly available funds to make upgrades in assessment technology and added professional and clerical staffing. These changes have directly benefited the assessment appeals program.

All staff appraisers can now access a commercial/industrial comparable sales database through personal computers or existing terminals. Assessor's staff continually input detailed property characteristics into a growing property characteristics database.

Direct access to stored comparables information and use of spreadsheet formats contribute to accuracy and standardization of the appeals presentations. Spreadsheet templates allow structured development of preparation of appeals cases.

## F. LOW-VALUE PROPERTY EXEMPTION

In our 1995 survey report, we recommended that the assessor request the county board of supervisors to adopt a resolution/ordinance exempting low-value property.

Our review at that time showed that there was no resolution exempting small assessments in Santa Clara County. However, the actual practice in the assessor's office was that small supplemental assessments were not enrolled and that some low-value properties were not assessed at all.

Accordingly, the county board of supervisors, upon the recommendation of the assessor, adopted Ordinance NS-220, exempting all personal property with an assessed value of less than \$2,000, and manufactured home accessories as defined in section 18005.5 of the Health and Safety Code with a base year or current full cash value of \$5,000 or less, when the accessories are installed on or added to manufactured homes purchased prior to July 1, 1980, that are subject to vehicle license fees.

SUGGESTION 1: Improve the low-value property exemption program by requesting that the present ordinance be amended: (1) to include all classes of property; and (2) to reflect current exemption limits.

### Include All Classes of Property

Santa Clara County's ordinance exempts only personal property and accessories for manufactured homes that are subject to vehicle license fees. By contrast, low-value real property is not exempted and must be assessed.

We suggest that the assessor seek to amend the existing ordinance to include real property and to reflect current exemption limits. We believe that this would not only fulfill requirements for equitable assessment, but save additional clerical and staff time otherwise spent processing assessments that are not cost effective.

#### Increase the Exemption Limits

Currently, section 155.20 allows ordinances to exempt from assessment all real and personal property with a current full cash value or base year value of \$5,000 or less. The current exemption level of \$2,000 on personal property does not take full advantage of the intent of the low-value ordinance that can eliminate “nuisance” assessments where the tax revenue does not justify the administrative costs of assessing, billing, and collecting.

The Santa Clara County tax roll shows that there are over 3,100 boats with values between \$2,000 and \$5,000. Smaller business property accounts and possessory interests are other examples where the benefit of expanding the exemption limit would result in a reduced workload. The time required to process these and other types of business and real property with values under \$5,000 could be reallocated to more productive areas.

We suggest that the assessor request that the county board of supervisors expand the exemption limit of the low-value ordinance. Such a change, combined with the expansion to include real property, should allow appraisers and auditor-appraisers to concentrate on audits and assessments that would better justify expenditures of staff and expenses.

#### G. DISASTER RELIEF

In our 1995 survey report, we noted that the Santa Clara County Board of Supervisors enacted ordinances granting property tax relief to owners of properties damaged by specific natural disasters. These ordinances allowed the assessor to grant midyear tax relief only to owners of property affected by specific events. Assessor’s staff currently track a limited number of parcels that have suffered a loss in value that was covered by such ordinances.

We reviewed the records for three flood damaged properties and found the value adjustments for property damage to be proper. In all cases applications were timely filed and physical damage confirmed. Assessor’s staff also made lien date checks on repairs in progress. Properties that are damaged by fires or other disasters during all other times may only be adjusted in the processing of lien date assessments.

The assessor recently recommended that the county board of supervisors adopt an ordinance authorizing property tax relief for property damaged or destroyed by misfortune or calamity after January 1, 1997. On January 28, 1997, the Board of Supervisors enacted Ordinance No. NS-300-593, a continuing ordinance in accordance with section 170, that grants property tax relief to all property that suffers a loss in value from calamity or misfortune. The ordinance permits the assessor to reassess and to provide property tax relief where damage exceeds \$5,000

as a consequence of misfortune or calamity, whether or not it is proclaimed by the Governor to be in a state of disaster.

Subsequently, due to the floods of January 1997, the assessor issued a number of press releases announcing this new tax relief for victims of the flood. We commend the assessor for taking this proactive step in informing the public. We do have a suggestion for instituting a discovery program for other potential property subject to disaster relief.

SUGGESTION 2:     Use additional sources to discover property that has suffered a decline in taxable value because of misfortune or calamity.

We found that the assessor has not yet requested, and does not currently receive, a listing of structure fires from any of the fire suppression agencies in Santa Clara County. We suggest that the assessor request that fire suppression agencies within the county periodically provide a list of structure fires and notify his staff to begin identifying properties that would qualify for relief under the new ongoing ordinance.

#### H.     ROLL CHANGES

Escape assessments are assessments made after the assessor has certified the completed local roll prepared pursuant to section 601. Upon discovery of property escaping assessment, the assessor must immediately add the escape assessment and any applicable penalty and interest to the local roll. It is common for an audit of a taxpayer's books and records to result in changes to the original assessment. Some audits covering a four-year period may have an overassessment one year and an underassessment in another. When a change results in a reduction in the assessed value, the assessor notifies the taxpayer of the amount of the excess valuation and that a claim for cancellation or refund may be filed with the county as provided by section 5097, et seq.

The business property division processes in excess of 12,000 roll changes (escapes, corrections, and cancellations) per year. The control desk is the focal point for all roll change. This desk handles secured as well as unsecured roll changes. These changes are reviewed for accuracy, numbered, recorded, and sent via computer to the auditor.

Our review showed that the roll change process is efficient, accurate, and well run. We commend the assessor and his staff for their excellent work in processing all types of roll changes timely and accurately.

### III. REAL PROPERTY ASSESSMENT PROGRAM

#### A. APPRAISAL PROGRAM

The major annual goals and responsibilities of the real property division of the Santa Clara County Assessor's Office are outlined as follows:

- Produce market value appraisals on every parcel that has experienced a change in ownership or new construction.
- Reappraise any property that has suffered a decline in value.
- Prepare and present appeals before the local assessment appeals board.

The statistics derived from CPTD's appraisal sampling of the 1996-97 roll in Santa Clara County represent the overall quality and condition of the assessor's operation for that roll year. Our sampling of 328 roll entries included 282 assessments of real property other than trade fixtures. Of these, 17 were appraised by CPTD appraisers at values different from the assessed values enrolled by the assessor's staff. Specifically, the local roll value exceeded CPTD staff values in three sample items while in 14 sample items CPTD staff values were higher.

Value differences noted in five sample items were caused by transfers and assessable new construction that were not assessed timely. These problems will be discussed in the change in ownership and new construction sections of this report. The remaining value differences were caused by procedural exceptions, varying appraisal judgments, and other areas of disagreement between CPTD staff and assessor's staff. It is our opinion that these differences do not indicate any major deficiency in the assessor's real property program.

#### Organization of the Appraisal Section

At the time of our fieldwork in March of 1997, the permanent professional staff assigned to handle the real property workload consisted of a chief appraiser, an assistant chief, seven supervising appraisers, 24 senior real property appraisers, 43 appraisers I and II, and two senior auditor-appraisers. The permanent professional staffing remained largely unchanged since our 1995 survey report.

The staff is allocated among seven districts and an appraisal support unit. The primary responsibility of Districts I, II, and III is performing appraisals on all single-family and small (under five units) multi-family properties in the county. They are also involved in training, working with appraisal aides, and appraising certain special use properties and properties subject to various recent constitutional amendments (e.g., parent-child transfer exclusions, base-year value transfers for those 55 years of age and older).

Staff in Districts IV and V are responsible for appraising all commercial-industrial properties in the county except the unique properties assigned to District VI. They also prepare

appeals and attend hearings for commercial-industrial properties before the local assessment appeals board.

The staff assigned to District VI values selected commercial-industrial properties that require special knowledge and experience, such as large electronic and heavy industrial properties, regional shopping centers, and oil and gas properties. The staff assigned to District IX is responsible for preparing and presenting appeals for single-family and multi-residential properties before the local assessment appeals board. They also appraise the multi-residential properties in excess of five units.

Since our 1995 report, there have been other significant changes in the real property division of the Santa Clara County Assessor's office. The county's participation in the State-County Property Tax Administration Program (AB 818) has made it possible to add additional professional and clerical staffing. Personnel hired under this loan program are considered temporary unclassified employees for the duration of the contract between the county and the State Department of Finance. At the time of our survey fieldwork, ten senior appraisers and three appraiser IIs have been added under the first contract period, and they comprise an "augmentation crew" appraisal district dedicated to reducing the large backlog of assessable new construction and changes of ownership.

An additional duty assigned to the real property division is the consolidation of appraisal data that has been kept by individual appraisers for use in their assigned geographical areas. In-house data, previously unavailable to all appraisers, will be arrayed in standard formats and added to the appraisal information that is now available. Appraisal staff are also assigned to update the assessor's policy and procedures manual, and they have completed a significant number of revisions and additions to the administrative manual as well as the valuation manual.

The division utilizes "Comps On-Line" and a CD-ROM cross-reference directory of the Revenue and Taxation Code. The office has developed a computerized comparable sale access and analysis program, allowing them to generate on-line appraisals and finished appraisal reports. This appraisal format has contributed to their ability to successfully resolve a record number of appeal applications this year.

## **B. CHANGE IN OWNERSHIP**

In any given year, the assessor's office receives approximately 70,000 documents from the county recorder's office; about one-third are determined to be reappraisable transfers.

The assessor's office installed a direct connection to the county recorder's AS 400 Optical Document System for researching deeds. The system automatically updates grantee names in the assessor's database, eliminating duplicate data input. The recorder's office labels each document as either "automatic" (assessor must see) or "review" (needs review by the assessor's office for selection or rejection) and forwards them electronically to the assessment services division of the assessor's office.

Within ten days of recording, the recorder's office is finished with the deed so that the assessment services division can print and review the deeds and then match them with their corresponding Preliminary Change of Ownership Reports (PCOR). Roughly four to six weeks after the date the information is received, the assessment services division will have completed analysis and update of ownership changes on the Assessor's Information Management System (AIMS). Split parcels, complex determinations of reappraisability, and any problem deeds are also resolved by assessment services division. The assessment standards division performs an internal audit of all deeds processed by the assessment services division.

The assessment standards division analyzes incoming PCOR's and assigns a code classifying the quality of the information. In the absence of a PCOR, the assessor's office sends the transferee its own Sales Verification Letter instead of the Change in Ownership Statement (COS). As noted in our 1995 report, the assessor's management believes that the magnitude of the penalty and abatement procedures involved would significantly offset the marginal increase in the response rate generated by the COS. Staff estimate that the standard PCOR, in conjunction with the use of their own Sales Verification Letter, generates a 95 percent response, and that this rate is sufficiently reliable for working reappraisable transfers and extraction of data.

Every six weeks the information systems division downloads deed information and other appraisal work data (e.g. new construction, new parcels), from the main database (AIMS) to print a report called the Parcel Activities List (PAL). The PAL is a cumulative listing of outstanding work segregated by appraisers' assigned work areas. It is designed to give appraisers a working file and to provide them with a data entry sheet for value changes.

The assessor's office enrolls many of the reappraisable residential transfers through direct enrollment. It is an efficient means of processing condominium units and single-family properties in given areas. The program enables the assessor's office to cope with increased workloads without a corresponding increase in staff.

The direct enrollment program creates a selective file of sales previously analyzed and determined by the standards division to be highly reliable indicators of value. These changes in ownership are subjected to further analysis by way of a Computer Assisted Appraisal Program (CAAP), that is, a multiple regression program that predicts the estimated market value of a subject property. If the confirmed selling price falls within the range established by the regression formula, it is enrolled by the program without detailed analysis, subject to appraisal review.

#### 1. Change in Ownership Backlog

The assessor's office is in the process of eliminating a large backlog of transfers and new construction. The previous assessor made a conscious decision to have staff concentrate on an unusually large assessment appeals workload, thereby creating a backlog of assessable transfers and new construction of commercial and industrial properties.

With additional staff provided by the AB 818 funding, the current assessor made a concerted effort over the last year to significantly reduce this backlog. In just over one year's

time, with the added support of the newly recruited team of appraisers, assessor's staff have worked 51,327 transfers out of an outstanding 55,167. As of February 28, 1997, staff had reduced the accumulated backlog of assessable transfers to a count of 3,840. In the past year the assessor's office has done an admirable job in eliminating the backlog of reappraisable transfers that accumulated over the past years.

## 2. Improvement Bonds

Improvement bonds are a form of public financing usually associated with land improvements that generally enhance land value. To obtain this type of financing, land benefiting from the improvements must be pledged as a security for the payment of the loan. As a lien against the land, an improvement bond is an obligation that must be assumed by the land owner. For this reason, when using the comparable sales approach, the appraiser should include the unpaid cash equivalent value of any bonds outstanding as an adjustment to selling price.

RECOMMENDATION 1: Obtain bond information from the tax collector's and auditor-controller's offices.

Effective January 1, 1996, section 163 requires all entities that receive payments from assessment bonds issued pursuant to the 1911, 1913, and 1915 Bond Acts to annually notify the assessor of lien amounts on each parcel at the time the lien was created, the date and amount of the payment in satisfaction of the lien, and remaining principal balances of the lien on each parcel.

The intent of section 163 is to aid the assessor in collecting improvement bond information from the issuing entities so that the cash equivalent value of this bond can be added to the nominal sale price of the property to determine the cash equivalent sale amount. In Santa Clara County, improvement bonds issued by the City of San Jose account for about one-half of all bonds in Santa Clara County.

The City of San Jose complies with section 163, but other cities in the county rely on the tax collector to maintain bond information. In our previous survey, we noted that there was no interface between the tax collector's system and the assessor's office. The tax collector's computer system is antiquated and lacks the capability to supply up-to-date information on improvement bonds. And while the tax collector's office is currently working to upgrade the system, satisfactory transmission of bond information will not occur before 1998.

For areas outside the city limits of San Jose, the assessor's staff now rely primarily on information supplied by purchasers of the property on the PCOR's to make the necessary adjustments to arrive at the cash equivalent sale price. The cash equivalent sales price must include the cash equivalent value of outstanding bonds assumed by the buyer. Few purchasers know the remaining principal amounts of the bonds encumbering their property; and, inevitably, outstanding bond balances are not reported by all purchasers and are thus overlooked by the assessor's appraisal staff.



The Santa Clara County Auditor-Controller's Office has identified most, if not all outstanding bond issues within the county. The auditor-controller's records include printouts listing all parcels within a given bond district, and the auditor-controller's staff can obtain, or direct assessor's staff to, sources listing remaining principal balances.

Regardless of the fact that the tax collector's computer system may be unable to directly transmit the necessary bond data, other avenues exist for obtaining this information. The assessor's office should obtain this information from other available sources.

We recommend that the assessor's office work with the tax collector's and auditor-controller's offices to obtain all bond information, identify sold properties encumbered with improvement bonds, and adjust the property's nominal selling prices by adding the cash equivalent value of the bond payments remaining at the time of sale.

Note that the nominal price adjusted by the bonded indebtedness is a value indicator; it does not necessarily represent market value. The reliability of the indicator must be resolved by the appraiser prior to being enrolled as market value.

## C. NEW CONSTRUCTION

### 1. Building Permit Processing

Santa Clara County has 16 building permit-issuing agencies that issued about 31,000 permits for the 1995-96 fiscal year. The assessor's office receives permits from the majority of the agencies on a monthly basis. Permits from the Cities of Santa Clara and San Jose are received on a weekly basis, and permits from the County of Santa Clara are received daily.

Clerical staff in the appraisal support unit of the real property division cull permits and discard those related to nonassessable activity. After verifying parcel numbers and owners' names and addresses on the remaining permits, they enter all permit information for assessable construction into the AIMS.

Within 60 days from the permit issue date, the AIMS prints labels to be attached to new construction questionnaires requesting property owners to furnish information on the permitted construction. Staff record data from returned questionnaires on the database and route the permit to the appraiser.

When there is no response to the questionnaire, or if the permit value on residential property exceeds \$150,000, an appraiser decides whether a second questionnaire or an inspection is needed. Senior commercial/industrial appraisers generate their own new construction questionnaires and make personal contact with the taxpayer either by telephone or on-site inspections.

Upon completion of the permitted construction, the appraiser records the permit number, date, and action taken on the appraisal record and enters the new value into the database.

**SUGGESTION 3:**     Maintain a list of discarded building permits and periodically review the list for construction that might accumulate to an assessable level.

All permits that combine more than one type of construction activity on one permit (e.g. addition, plumbing and electrical) are added to the AIMS. By contrast, most individual permits for nonassessable construction activity are destroyed. Consequently, we were unable to determine the percentage of incoming permits resulting in assessable construction; but, more importantly, permit data from destroyed permits are not made available to appraisers.

A building permit issuing agency may issue separate construction permits to separate contractors for a single reassessable event. Therefore, while permits for all-encompassing “tenant improvements” may be retained for appraisal action, separate permits issued for electrical, air conditioning, heating, and plumbing are discarded for being of low value. Yet, cumulatively they could represent installation of similar “tenant improvements.”

Staff appraisers should be made aware of all the component permits before making a decision regarding reappraisal. Recording all permits would aid in the timely discovery of assessable new construction indicated by an accumulation of permits to a particular property. When several permits are issued to a given assessor’s parcel number (APN) or to a given leasehold tenant within a short period of time, appraisers would be alerted to inspect for assessable construction.

We suggest that discarded permits be listed by assessor’s parcel number and further identified alphabetically by assessee or lessee. These lists should be periodically reviewed to search for groupings of permits that, in aggregate, indicate assessable construction activity. In this way, staff will reduce the likelihood of escaped assessable new construction which results from the discarding of separately issued construction permits.

**2.     New Construction Backlog**

In Santa Clara County, as in many areas of California, property values have declined or stagnated in the past few years due to economic conditions, which in turn created an increase in filings of assessment appeals.

As mentioned earlier, the previous assessor found it necessary to address with urgency the rapidly expanding appeals caseload and ensure that it was kept manageable with the available staff. In 1991, he decided that his senior staff appraisers would concentrate on resolving assessment appeals cases on commercial and industrial properties, and delay enrollment of assessable commercial and industrial new construction if necessary. The current assessor continued this policy for the same reasons. These decisions consequently created a substantial backlog of assessments on new construction for commercial and industrial properties.

We recognize that the assessor had to prioritize his workload. However, the enrollment of new construction assessments should be a priority for timely handling as well.

The current assessor allocated a portion of the AB 818 funds to create a special commercial-industrial district or appraisal team, consisting of one supervising appraiser, eight senior appraisers, and an assessment clerk, to eliminate the backlog of assessable construction and changes in ownership. The newly formed augmentation crew has, in the past year, eliminated approximately 90 percent of the accumulated backlog of assessable new construction from the previous four years. We commend the assessor for moving so quickly to address this issue.

#### D. DECLINES IN VALUE

Section 51 requires the assessor to annually assess taxable real property at the lesser of either its factored base year value or its current market value, as defined in section 110. Situations in which the current market value of a property is lower than its factored base year value usually occur during periods of economic declines. As the economic situation improves, the current market value of the property may gradually increase above the factored base year value. When this happens, the factored base year value again becomes the basis for the assessment. Such situations demand the constant attention of an assessor's staff.

Santa Clara County residential property values reached their peak in 1989-90 and then began a dramatic decline. In response to this change in market conditions, the Santa Clara County Assessor's Office reduced the assessments of more than 29,000 single-family residential properties in 1991, some by as much as 16 percent. These were single-family residences that had been purchased since April 1989 and qualified for a reduced assessment pursuant to the requirements of section 51.

Until the 1990-91 roll, section 51 reviews were initiated by individual taxpayers filing requests for review of their assessments. Upon receipt of such a request, an appraiser conducted an in-office review using comparable properties in their database. The taxpayer was notified of the result of this review by one of two letters. One states that there is no evidence to support a reduction in value, and it suggests that they file either an application for reduced assessment, if timely, or another request for review next year. The other letter indicates that there has been a decline in value and gives the assessor's opinion of the new value.

In 1991-92, the assessor's office implemented a county-wide mass review of all residential property. Staff analyzed residential sales from previous assessment years and calculated the mean and median selling price for each quarter of the assessment year. These quarterly figures, indexed forward by the appropriate inflation factor, were compared to the current mean and median values as of the lien date under review. The comparisons were used to determine which quarters' sales would need downward trending and the percentage of reduction necessary to adjust assessed values to current market levels.

Condominiums and townhouses were analyzed separately from single-family, detached homes. The decrease in value in condominiums and townhouses was not as pronounced as that found in single-family detached residences. Commercial, industrial, and apartment properties were not part of this mass review and were individually reviewed for declines in value.

By 1995, the number of assessments reduced for a decline in value had grown to almost 96,000 properties, or nearly 23 percent of the county's 423,000 real property parcels. During a five year-period, these properties received assessment reductions from 1.2 percent to more than 25 percent of their base year values, depending upon the date of acquisition.

In 1995, there was some indication that the real estate market had reached a low point; and by 1996, Santa Clara County experienced an economic recovery as the residential market values began to rise. Accordingly, the assessor's office conducted another mass review of residential property values, again applying statistical techniques to analyze residential market trends.

In the course of the review, assessor's staff noted that high school districts delineated areas with different rates of recovery. And because they served as the most reliable and recognizable geographic indicators of market desirability, staff used them in determining the appropriate adjustment for declines in value.

The review of residential properties that had previously suffered declines in value provided the basis for restoring about 11,300 parcels to their factored base year values for 1996. While approximately 1,600 additional properties will receive an increase of 9.6 percent, the highest restoration factor, the average increase for the county will be 2.75 percent. Commercial, industrial, and apartment properties were not included in this review. Values for these property types were individually reviewed.

The Santa Clara County Assessor's Office was one of the first in the state to reduce assessments for residential property values using a mass review. It is also the first to restore values in an economic recovery by using regression analysis.

From our review it is apparent that the assessor and his staff have done an excellent job of monitoring property values within the county. All of the properties that have been reviewed and reduced in value are tracked for annual review. We did, however, note one procedural error that the assessor should correct.

**RECOMMENDATION 2:** Adjust taxable values only when the change can be supported from market data.

The assessor's office reduced assessments for over 29,000 single-family residential properties for the 1991 roll year by as much as 16 percent. Single-family residential property values remained static in 1992 and 1993, and were further reduced in 1994. Residential values remained unchanged in 1995 from 1994 levels.

However, assessments for commercial, industrial, rural, and multi-residential properties were individually reviewed for declines in value, and the taxable value remained unchanged when appraisers could support neither a value increase nor a decrease. The assessor's staff reviewed the values of commercial/industrial properties for the 1996 roll. The staff believed

that there was some increase in the market value but could not quantify this change. Therefore, they elected to use the Board announced inflation factor of 1.11 percent.

Market values enrolled to recognize value declines should be reviewed each year. Each year a current market value estimate should be enrolled until it is higher than the factored base year value. At that time, the factored base year value resumes as the taxable value. While the appraisal staff may believe the factored increase approximates the market increase, it is highly unlikely that a property's market value increases in exactly the same amount as the Board-announced inflation factor.

The assessor's office automatically indexed the 1995 real property assessment to reflect an increase in value. In the future, we recommend that the assessor's office not apply the inflation factor to the prior year's taxable values to recognize a value increase without supporting documentation.

In 1996 Santa Clara County initiated an education strategy to inform taxpayers of potential assessed value increases. Approximately 44,000 residential taxpayers who previously received assessed values less than the factored base year value and had an increase in assessed value were mailed letters explaining the reasons for the increase. The letters of explanation were mailed to affected taxpayers approximately one week after they received the annual assessment notification card which the assessor's office routinely sends to all property owners in early May. Various versions of the letter are issued depending upon whether there was a partial or full restoration of the factored base year value as the assessed value.

## E. SPECIFIC PROPERTY TYPES

### 1. California Land Conservation Act

An agricultural preserve property subject to a contract pursuant to the California Land Conservation Act of 1965 (CLCA) is assessed on the basis of its agricultural income-producing ability, including any compatible use income (e.g., hunting, communication facilities). The taxable value of the property is limited to the lowest of this restricted value, the current market value, or the factored base year value. Sections 423 through 430.5 provide the guidelines for assessing land subject to a CLCA contract.

For the 1996-97 lien date, Santa Clara County had 355,383 acres encumbered by CLCA contracts consisting of about 2,900 parcels. Approximately 23,800 acres were in nonrenewal status, and 658 acres were enrolled at the factored base year values because they were lower than the restricted values. The total taxable value of CLCA land was \$125 million; this is less than one-tenth of one percent of the real property portion of the 1996-97 assessment roll. Fruit and nut bearing living improvements (trees and/or vines) are not assessed consistently in Santa Clara County.

One senior property appraiser is responsible for the annual valuation of all CLCA properties in Santa Clara County. In addition to the CLCA workload, he is assigned to appraise

all transfers and new construction in five assessor map books, Timberland Production Zone (TPZ) properties, and historical properties under contract, and he oversees the work of two residential property appraisers.

The CLCA assessment program was computerized about 12 years ago. The computer program calculates the restricted values and compares the restricted values with the factored base year value to determine the taxable value. It also calculates the nonrenewal value for those properties in nonrenewal status.

Annually, the assessor sends an Agricultural Preserve Questionnaire to all property owners of land subject to a CLCA contract. This questionnaire requests information on agricultural and compatible use income, and type of agricultural use (field/row crop, grazing, orchard/vineyard, irrigated/nonirrigated). Currently, this questionnaire is the primary source of the income data utilized in determining the estimated market rent on CLCA properties in Santa Clara County. The return rate is from 50 to 60 percent; and, of those questionnaires returned to the assessor, only about 30 percent have useable information. Most counties, whose policy is to send questionnaires, have a return rate of 75 to 85 percent.

One recommendation in our previous report was to assess trees and vines, and use AUM (animal unit months) measurements to value grazing lands. The assessor has not changed this policy on the assessment of trees and vines, or on using AUMs. We repeat this recommendation and add other recommendations for improving this program.

RECOMMENDATION 3: Revise the CLCA program by: (1) assessing trees and vines; (2) using animal unit months (AUMs) as the unit of measurement in assessing grazing land; (3) deducting a charge from the income stream for return on and of investment in nonliving improvements; (4) deducting a capital replacement charge for irrigation wells; and (5) incorporating the current market value test for determining taxable value.

### Valuing Trees and Vines

The assessor places very low priority on the assessment of CLCA properties. This is understandable considering the 1996-97 taxable value of these properties was less than one-tenth of one percent of the real property portion of the assessment roll. His response to our recommendation in the last survey to assess trees and vines was that “[t]hose properties under open space contract which have living improvements (trees and/or vines) are generally located in areas of the county which are in transition to higher uses. As a consequence it has been our experience that these living improvements contribute little if any economic value above the underlying value of the land.”

Section 429 provides:

Notwithstanding the provisions of section 105(b) of this code, in valuing land enforceably restricted pursuant to this article, fruit-bearing or nut-bearing trees and vines on the land and not exempt from taxation shall be valued as land. Any income shall include that which can be expected to be derived from such trees and vines and no other value shall be given such trees and vines for the purpose of assessment.

Producing acres of cherries and vineyards have increased in Santa Clara County. These new plantings indicate that trees and vines within the county add to the total property value of agricultural property. In addition, restricted properties under CLCA contract are valued based on their agricultural income-producing ability, not their transitional or a potential higher use. Therefore, any net income from trees or vines over and above the land income should be capitalized into a tree or vine value.

We recommend that when valuing restricted land with living improvements, the assessor review the gross rent used to ensure that all income to the property is included and that any excess income above bare land income be capitalized into a value for the living improvements.

#### Animal Unit Month (AUM)

The recommendation concerning AUMs in our prior survey was a repeat of a 1989 recommendation. At that time, we believed that the AUM unit of comparison for grazing land was the most logical unit to use when valuing grazing land. We continue to believe this since it more accurately measures the productivity of the grazing properties. We recommend that the assessor's staff analyze grazing capacity in terms of AUMs.

#### Nonliving Improvements and Wells

The income used to value irrigated land and vineyards in Santa Clara County includes income attributed to nonliving improvements, such as fixed pumps, permanently-installed pipelines, drip irrigation systems, and vineyard stakes and trellises. Nonliving improvements are valued separately by the cost approach. Consequently, a charge must be deducted from the total property income for return on and of the investment in these nonliving improvements or a double assessment occurs. We recommend that the assessor's staff deduct a charge from the total property income for a return on and of the nonliving improvements.

### Irrigation Wells

Another expense we found not accounted for by the county was a capital replacement charge for wells that contribute to the earning ability of the land being appraised. Wells may be the sole source of water supply, or used for supplemental water in an irrigation district. They are classified as land for property tax purposes and return on investment is included in the land capitalization rate; nonetheless, they are a wasting asset, and a charge for replacement must be subtracted from the total property income.

We recommend the assessor revise his CLCA computer program so that it calculates the proper charges for replacement of irrigation wells.

### Current Market Value Test

Currently, the assessor's computer program only compares restricted land value to the property's factored base year land value. This leaves out one of the tests required for the assessment of CLCA properties. Section 423 (d) provides in part that:

Unless a party to an instrument which creates an enforceable restriction expressly prohibits such a valuation, the valuation resulting from the capitalization of income method described in this section shall not exceed the lesser of either the valuation that would have resulted by calculation under section 110, or the valuation that would have resulted by calculation under section 110.1, as though the property was not subject to an enforceable restriction in the base year.

We recommend the assessor revise his program so that it reflects the comparison between (1) the restricted value, (2) the current market value, and (3) the factored base year value of the restricted property and enrolls the lowest of these values.

### Field Review All CLCA Properties

SUGGESTION 4: Improve the California Land Conservation Act (CLCA) program by field reviewing all CLCA properties.

In our review of the CLCA appraisal records, and in discussions with the senior appraiser who is responsible for the valuation of all CLCA properties in the county, we found that most of the properties had not been field-reviewed in years. The property records have little or no documentation pertaining to size, description, or productive capabilities of the ranch or farming unit.

One property we reviewed was planted to wine grapes within the last few years. It was improved with stakes and trellises, overhead solid-set sprinkler system, and drip irrigation. However, the latest date we found on the appraisal records pertaining to improvements was 1983.



There was some written correspondence pertaining to an August 1991 transfer. However the only other documentation found was a note indicating the CLCA contract terminated February 28, 1991 and a computer printout listing the assessed values.

It would be cost effective for the assessor to increase his rural appraisal staff temporarily and properly field review all the CLCA properties in Santa Clara County. We estimate it would take 2.6 person years, based on 225 work days per year, to initially complete the reappraisal program. There are approximately 2,900 parcels controlled by 1,462 land owners. We estimate that the \$125 million CLCA value on the 1996-97 assessment roll would increase a minimum of 20 percent because there appears to be at least a 20 percent differential between reported rent and actual rent used in determining the restricted value. This would generate an additional \$250,000 in tax revenue per year. When the reappraisal program is completed, we believe that one senior property appraiser could maintain the program, assuming the program is computerized.

## 2. Rural Property

SUGGESTION 5: Increase documentation on appraisal records.

The majority of the rural property in Santa Clara County not subject to a CLCA contract is in transition to a higher use. We reviewed various records and found that the appraisal files contained limited supporting documentation and other pertinent data, such as a description of the property size, and use of total unit.

We suggest that the county improve record documentation to include a brief description of the property and a summary of the valuation approach. This would help the staff explain the appraised values to taxpayers, facilitate appraisal review, and increase the quality of the appraisal program.

## 3. Section 11 Properties

The Constitution of California exempts from taxation property owned by a local government except lands and the improvements thereon that are located outside its boundaries that were subject to taxation at the time of acquisition. Taxable government-owned properties must be assessed in accordance with the procedures specified in article XIII, section 11 of the California Constitution. These properties are commonly referred to as section 11 properties.

Section 11 governs the methods by which improvements may be assessed, and these may differ substantially from ordinary assessment procedures. The value of any improvement is established when the property is acquired by the local government. Subsequently, the assessor enrolls the lower of the factored base year value or the current market value. Improvements constructed subsequent to acquisition are exempt unless a structure replaces one that existed prior to acquisition by the agency. In that case, the value of the replacement cannot exceed the highest value placed on the replaced structure.

Valuation of land is similarly prescribed by section 11. Reviewed annually, the taxable value of the land must be the lowest of (1) the 1967 assessed value multiplied by a factor supplied annually by the State Board of Equalization (Phillips Factor), (2) the current fair market value, or (3), as recently decided by the California Supreme Court in *City and County of San Francisco v. County of San Mateo et al*, (1995) 10 Cal. 4th 554, the value determined under article XIII A of the California Constitution (Proposition 13).

RECOMMENDATION 4: Properly assess all properties subject to the provisions of article XIII, section 11 of the California Constitution.

In Santa Clara County two appraisers prepare the assessments of 148 section 11 properties. For 122 parcels, the assessor enrolled the factored 1975 roll value in accordance with the provisions of article XIII A of the California Constitution as recently decided by the State Supreme Court. However, the remaining 26 section 11 properties have not been reviewed for the Proposition 13 limitation.

We recommend that the staff review the remaining section 11 properties to determine whether the 1975 base year value factored provides the lowest value to be enrolled.

#### 4. Possessory Interests

Two real property appraisers in District VI are responsible for about 2,800 possessory interest assessments. The assessments are located on property owned by 98 public agencies. One appraiser reviews the assessments of those located on real property owned by five public retirement systems, and the other appraiser reviews those located on real property owned by the other 93 public agencies, including 15 city agencies, five airports, 37 college and school districts, two hospitals, five state agencies, and the U.S. Department of the Interior.

The appraisers annually contact the public agencies with questionnaires requesting leases, rents, expenses, and other pertinent information. Information from these questionnaires is used to appraise the possessory interests.

Usually, the staff use the direct income approach to value possessory interests. This approach requires the appraiser to determine a market rent and capitalize it for a term of possession into an indicator of value. Most of the rents used are the actual rents. Normal expenses, usually around 15 percent, are always deducted, and a 10 percent yield rate is used. Other rates are used when the market indicates it. After the appraisal is reviewed by the District VI supervisor, it is enrolled on the unsecured roll.

The assignment of a separate appraiser to handle the five public employee retirement properties was the result of our recommendation in the October 1995 survey report. We commend the assessor for implementing our recommendation.

The possessory interest staff diligently contacts the 98 public agencies for needed information, and they are thorough in their documentation of individual appraisals. It is easy to

follow their value calculations. In many cases, the appraisal includes a copy of the lease or rental agreement creating the taxable possessory interest. We commend the assessor for monitoring an excellent possessory interest program.

## 5. Manufactured Homes

There are 6,380 manufactured homes assessed on the Santa Clara County tax roll with a total value of \$226,413,434. In addition, there are about 11,000 manufactured homes located in the county that are still subject to vehicle license fees. The majority of the manufactured homes are located in the 110 rental parks in the county.

The business property division is responsible for the appraisal of manufactured homes located in mobilehome parks. The real property division is responsible for appraising manufactured homes located outside of mobilehome parks.

The assessor's office is notified of sales of manufactured homes by the Department of Housing and Community Development. The business property division receives all notifications, either on computer lists or copies of dealer's reports of sale. A property file is created for each manufactured home; it includes a drawing of the home, the decal number, identification number, the make, model, year of manufacture, accessories, foundation type, condition, and other pertinent details regarding the ownership of the underlying land.

Because housing is scarce and expensive in Santa Clara County, and park rents are controlled by local ordinances, the nominal sale prices of manufactured homes situated in rental parks can include a premium above the value of only the manufactured home. The assessor's staff correlates three indicators of value with the sales price to compensate for the in-park site value. These indicators are: The Kelley Blue Book value, the value indicated by Assessors' Handbook, section 531, and the value indicated by the National Automobile Dealer Association's Mobilehome Manufactured Housing Appraisal Guide. The greatest weight is usually given to the value indicated by the Assessors' Handbook.

Whenever a manufactured home is installed on an approved permanent foundation, it is no longer a manufactured home but is assessed as real property. In our 1995 report we found that accessories associated with manufactured homes subject to vehicle license fees were not being assessed. At that time, Santa Clara County did not have an ordinance that would authorize the assessor to exempt manufactured home accessories.

Because manufactured home accessories usually have a low value and are time consuming to discover and appraise, we suggested in our 1995 report that the assessor work with the board of supervisors to adopt a low-value property exemption ordinance that would apply to the appropriate manufactured home accessories. The county board of supervisors has since adopted an ordinance that exempts manufactured home accessories with a base year or full value of \$5,000 or less. This exemption applies only to those accessories that are associated with manufactured homes licensed by the Department of Motor Vehicles. It cannot be used to exempt accessories on taxable manufactured homes.

The other area of concern mentioned in the 1995 report was the assessment of manufactured homes with declines in value below factored base year value. The county's computer program was not making a proper analysis for taxable value purposes.

Taxable values of real property, as stated in the 1995 report, are properly developed by comparing current market value of a property to the property's factored base year value, and enrolling the lesser of the two values. The county's computer program is not making this comparison, but instead compared the prior year's taxable value to an indicator of current market value and enrolled the lesser of the two. The prior year's taxable value for the manufactured home is not necessarily its factored base year value, but instead could be the manufactured home's current market value for that prior year.

The assessor has revised his computer program for manufactured homes. It now compares the current market value and the factored base year value, and in addition, now tracks and compares each year's market value. We commend the assessor for addressing our concerns raised in our 1995 report.

Overall, the assessment program for manufactured homes in Santa Clara County is well run and its procedures are consistent with relevant statutes.

#### 6. Water Companies

Water company properties assessed on local tax rolls may be either municipal systems on taxable government-owned land (article XIII, section 11 of the California Constitution), private water companies either unregulated or regulated by the California Public Utilities Commission (CPUC), or mutual water associations. Each type presents different assessment issues.

##### Municipal Water Systems

The Constitution of California exempts from taxation property owned by a local government within its boundaries (article XIII, section 3(b)). This excludes from assessment property owned by city water departments or water districts located within city limits or district boundaries. However, when the water system is located outside of the government agency's boundaries, this exemption does not apply. In those cases, article XIII, section 11 of the California Constitution provides that publicly owned water system property located outside its boundaries is taxable if it was taxable at the time it was acquired by the city or district.

In our review we noted a number of such parcels owned by a water system but located outside its jurisdiction. The assessor's staff had correctly assessed them using procedures outlined in the section 11 portion of this report.

## Private Water Companies Regulated By The CPUC

Regulated private water companies are operated for profit and may be regulated by the California Public Utilities Commission (CPUC) depending on the number of customers. Real property owned by these water companies is also subject to the assessment limits of article XIII A of the California Constitution. The current market value of real property owned by a private water company may be less than its factored base year value, making it necessary to annually determine the market value of the real property as well as any personal property subject to ad valorem tax.

There are seven regulated private water companies in Santa Clara County. Our review of the county's business property files showed that five of the private water companies had filed business property statements. Our 1995 survey report identified several private water companies operating in the county in 1990 that had never been assessed. We recommended that the county identify and assess all private water companies. Since then, the county has reviewed information from CPUC and assessed four additional private water companies. We commend the assessor for implementing our recommendation.

RECOMMENDATION 5: Develop historical cost less depreciation and capitalized income value indicators for all private water companies; reappraise the transferred private water company.

Four recently assessed private water companies have been assessed at the factored base year value. One of these four companies underwent a change in ownership on December 15, 1994 but has not yet been reappraised.

As mentioned earlier, the current market value of the real property owned by a private water company may be less than its factored base year value. This is because the regulator's allowed operating revenue is theoretically a function of the rate base which may be declining. Thus, assessment based solely on the factored base year value may be a overassessment of the property of private water companies.

We recommend that the assessor's staff annually contact the CPUC to obtain copies of the annual reports of the private water companies. This will enable the assessor's staff to calculate the HCLD and income-approach value indicators. Also, the private water company that transferred on December 15, 1994 should be reappraised.

## IV. BUSINESS PROPERTY PROGRAM

### A. INTRODUCTION

The business property division is budgeted for one chief, one assistant chief auditor-appraiser, four supervisors, 37 auditor-appraisers, and 20 clerical staff. The staff is responsible for auditing 3,700 mandatory accounts, processing 72,000 business property statements, and assessing 8,300 vessels.

The County Property Tax Division's (CPTD) sampling of the Santa Clara County 1996-97 assessment roll included 46 secured and unsecured business properties. In 31 of these sample items, the county's assessed values differed from the values determined by CPTD staff. Specifically, the local roll values exceeded CPTD staff values in 10 cases, while in 21 cases CPTD staff values were higher.

Eighteen sample items involved problems with valuation factors. Valuation factors are the product of percent good factors (based in part on estimated service lives) and replacement price indices. The main reason for these differences is that the assessor's staff used shorter economic lives than CPTD staff.

The remaining value differences between CPTD appraisals and the county's assessed values for sampled business properties were due to differences in appraisal judgment or other areas that were not indicative of significant problems in the assessor's business property assessment program.

We found the business property division staff to be very competent and professional. The auditor-appraisers are well trained, knowledgeable, and motivated to produce an excellent work product. The support staff is helpful, knowledgeable, and efficient in supporting the professional staff and processing the work. They are supervised by a competent and knowledgeable management team.

The assessor is to be commended for instituting an automated, on-line petition program allowing for the elimination of an outdated, four-part form. Assessment clerks can now initiate roll corrections instantly. The on-line petition program also provides a historical value record that previously required extensive searches in files and microfiche.

### B. PROCEDURES MANUAL

Formal written guidelines are necessary to ensure continuity and standardization and to provide equal treatment for all taxpayers. It is also a valuable medium in conducting orientation and training of new staff members. These guidelines should include steps and procedures to be taken regarding sending and receiving property statements; late filing and penalty assessments; and audit preparation, scheduling, and notification.

SUGGESTION 6: Update and formalize the business property division's policy and procedures manual.

The day to day operation of the Santa Clara County Assessor's Office is governed by an eight volume policy and procedures manual. There is a separate volume for each of the following aspects of operation:

- Volume I - General
- Volume II - Administration
- Volume III - Assessment Services
- Volume IV - Assessment Standards
- Volume V - Valuation
- Volume VI - Real Property
- Volume VII - Business Property
- Volume VIII - Exemption

While the real property division has almost completed updating their portion of the manual, this is not the case with the business property division. The business property division's portion of the policy and procedures manual is basically the original adopted in the 1960's with some updates added in the 1970's and loose-leaf instructions in areas such as business property statement processing. These instructions, plus memorandums from the chief auditor-appraiser to the supervising auditor-appraisers, comprise the greater part of the business property division's procedures. Written procedures are not available for assessing leasing companies, leasehold improvements, agricultural properties, consigned equipment, service stations, aircraft, or vessels, nor are procedures available regarding failure to file property statements. In addition, there are no formal, written auditing procedures. Instead, there are a number of loose-leaf instructions that have accumulated over the years.

The business property division has an audit staff of 37 auditor-appraisers who are responsible for completing more than 3,700 mandatory audits over a four-year period. Although there are informal procedures in place to accomplish the large audit workload, these procedures need to be formalized and incorporated into the office's written policy and procedures manual.

A formalized auditing procedures section will not only enhance the quality and uniformity of the audits but will also provide formal support for the procedures used by the auditor-appraisers. Such a section would be an effective tool in accelerating the auditing process by eliminating time-consuming, repetitive oral instructions and the task of referring to scattered instructions which may or may not have approval for current use.

The absence of an up-to-date policy and procedures manual makes it more difficult to train new employees. Although the division has a structured 20-day training program for new auditor-appraisers, the process would be more effective for the trainee and instructor if a manual is used as the main text. The manual would not only reinforce the trainee's learning experience but would become a familiar reference handbook to use thereafter.

We were informed by the business property division chief that they planned to update the procedures manual two years ago but were handicapped by a staffing shortage due to unfilled vacancies in the clerical section of the business property division. These staffing problems have hampered the plan to enter the old manual sections, current written instructions, and memoranda into an electronic format. An electronic policy and procedures manual could easily be edited and updated.

We strongly suggest that the assessor give high priority to updating the business property portion of the policy and procedures manual.

## C. AUDIT PROGRAM

### 1. Mandatory Audits

The business property division has approximately 3,700 business and agricultural accounts that meet the mandatory audit requirements outlined in section 469. Of this total, approximately 560 are out-of-state audits. The mandatory audit workload is maintained on the county's IBM mainframe computer system which prints the Mandatory Audit Report to assist in managing this large audit workload.

The mandatory audit reports contain a four-year history of total assessed value for each account, the last year audited, and the projected year for the next audit. The report also indicates the location of the audit divided into three categories: local, non-local (outside Santa Clara County), and out-of-state. Exempt organizations are also included in the list.

From the mandatory audit report, a current year's assignment is prepared. The accounts over \$20 million, which number about 100, are selected by the chief auditor-appraiser and set aside for special assignment to senior auditor-appraisers. The balance of the audits to be completed for the current year are distributed to the supervising auditor-appraisers who make assignments to individual auditor-appraisers.

The Santa Clara County Assessor's Office is an active participant in and makes good use of the cooperative county audit program. Whenever possible, out-of-state mandatory audits are contracted out to auditor-appraisers from other counties who will be auditing the same taxpayer in major cities throughout the country. Likewise, Santa Clara County auditor-appraisers perform audits in their county for other counties.

Entities (individuals, partnerships, corporations, trusts) are assigned an entity account control number so that multiple businesses under the same ownership can be attributed to one owner and trigger the mandatory audit if the combined value is \$300,000 or more. Each additional business is assigned a sub-account number under the account control number.

When audits are completed, they are reviewed by the supervising auditor-appraiser and the chief or assistant chief auditor-appraiser. Mandatory audits are performed on a



timely basis. For those not completed, a waiver of the statute of limitations is obtained. When deficiencies caused by the assessee are disclosed, section 506 interest is indicated by the auditor.

A suggestion was made in the 1995 survey report that an “audit check list” be prepared and included in every audit. The staff has designed a very comprehensive one, and it was used in the audits performed during the 1996 audit period and thereafter.

Completed audits are filed in the property statement file and are thus available to staff members processing the current business property statements. This allows for the incorporation of past audit findings into current year valuations during property statement processing.

Auditor-appraisers are rotated each year so that they are not assigned to the same company in subsequent years. This is accomplished by assigning the supervising auditor-appraisers and his/her team to a different portion of the mandatory audit list each year.

Each year the business property division prepares a report entitled “Personal Property and Standard Division’s Secured Accounts over \$300,000.” This report is sent to the standards division so that properties can be considered and selected for “total property appraisal.” This report is limited to “secured” accounts. The standards division makes the decision as to which accounts will be selected for total property appraisal. When selected, an auditor-appraiser and a real property appraiser will be assigned to the account to make a “total property appraisal.” This procedure resolves classification problems between real and personal property, enhances escaped properties discovery, and helps to avoid duplicate assessments. The procedure is very time-consuming, and only a few “total property appraisals” are done each year.

We commend the assessor for developing and maintaining a very comprehensive and efficient mandatory audit program. Not only does the staff have very good control of the quantity and scope of the mandatory audits, they also complete most of them in a timely manner. For those few that are not completed timely, a waiver of the statute of limitations is requested. In addition, the assessor has developed a total property team concept in which staff from both real and personal property divisions participate in the appraisal of the largest properties in the county.

## 2. Nonmandatory Audits

Section 469 sets the mandatory audit threshold at \$300,000 full value. Accounts with full values below \$300,000 are not routinely audited. Taxpayer reporting errors or omissions in these nonmandatory accounts go uncorrected unless some problem triggers an audit.

A major objective of an audit program is to ensure proper reporting on the annual business property statements. Although there is no legal requirement to audit smaller businesses, no auditing program is complete unless it includes a representative sampling of all sizes and types of accounts. Errors in reporting business property costs on the annual property statement is one of the most significant and common differences noted in CPTD sampling of business property assessments. Unless an audit is performed, these reporting errors, and the resulting

revenue loss when a taxpayer underreports, will probably continue year after year. Additionally, taxpayers might purposely report incorrect costs to keep assessed values below the mandatory audit threshold and thus avoid an audit.

In our prior report, we recommended that the assessor request staffing to expand the nonmandatory audit program. Because of budget restraints, staff have not been able to conduct many nonmandatory audits. However, some nonmandatory audits are done each year because taxpayers request an audit to clear up problems, questions, and possible overassessments. Others are done because of errors or omissions discovered during the annual business property statement processing. Most of these audits are office audits wherein the taxpayer is requested to bring pertinent records to the assessor's office.

**SUGGESTION 7: Request additional staff positions to expand the nonmandatory audit program.**

For the current year, 110 nonmandatory audits were completed which added nearly \$10 million of value to the tax roll. The recovery rate was over \$25,000 of value per audit hour expended, which demonstrates the economic benefit that would accrue if the program were to be expanded.

Since budget issues are beyond the assessor's control, we suggest alternatively that the assessor increase the nonmandatory audit coverage as staffing becomes available. An opportunity currently exists to designate a portion of the AB 818 money to fund additional auditor-appraiser positions. Taxpayers reporting property having a full value below the mandatory threshold would be held accountable for compliance with the law. Audits would provide a basis for correcting both underassessments and overassessments.

**D. BUSINESS PROPERTY STATEMENT PROCESSING**

Business property assessments are based upon data submitted by taxpayers on the annual property statements. For mass appraisal purposes, it is axiomatic to say that the more accurate the data reported by taxpayers on the property statements, the more accurate the assessment roll will be.

The processing of business property statements is one of the most time consuming tasks in the business property program in an assessor's office. This is particularly true in the case of Santa Clara County. The assessor's office has on its assessment roll a large number of semiconductor, computer manufacturing, and high technology companies. Many of these accounts are not only extremely large and complex, but also present unique appraisal circumstances.

As of July 1, 1996 the business property division had processed 72,845 business property statements with a roll value of \$18,062,376,039. These include regular accounts (e.g., semiconductor, computer manufacturing, agricultural, apartments), banks and insurance

companies, and insufficient-to-assess (ITA) accounts. Excluded from these amounts are marine and aircraft statements.

The procedure for processing business property statements is described in a 35-page computer printout titled Personal Property Assessment System (PPAS). The PPAS is arranged alphabetically by topic and covers almost every significant area in processing business property statements. It has a step-by-step procedure for verifying signatures and other pertinent steps that need to be undertaken in processing statements. For additional guidance and procedures not included in the PPAS, the chief auditor-appraiser issues memorandums and instructions. The latter serves as updates to existing policies and procedures.

The assessor's office conducts a one-day seminar for the business property division staff prior to the start of the processing season. At this seminar, the processing assignments and the PPAS are discussed at length. One of the major topics included in the PPAS is the service life to be used to value a particular industry or business. This is simplified by an in-house developed "Business Classification Code" book that categorizes businesses by assigning a classification code from "036 to 944." Each classification code number has a corresponding service life assigned and, when needed, a percentage split between the personal property and fixture typical of the business.

The 1996 processing assignments were handled by three units each supervised by a supervising auditor-appraiser. Assignments were based on the first two digits of the account number.

We commend the assessor and his business property division's chief auditor-appraiser for this sound approach in processing property statements. We do, however, have a recommendation to improve this good program.

The Board annually publishes Assessors' Handbook section 581 (AH 581) which contains index factors for 20 equipment categories and percent good factors. The equipment index factors are used to adjust the acquisition costs of equipment reported on the business property statement so as to approximate replacement cost new (RCN). The percent good factors are then applied to the RCN, resulting in an estimated replacement cost new less normal depreciation (RCNLD). For the cost approach, RCNLD is the most commonly used indicator of fair market value or full cash value of the equipment.

Table I in the AH 581, "Commercial Equipment Index Factors," contains schedules for 12 classes of commercial establishments (e.g., bank, hospital, restaurant). Table II, "Industrial Machinery and Equipment Factors," contains schedules for six groups of industrial equipment. In each group, a number of industrial establishments are listed (e.g., electronic, mining under Group 2; chemicals and allied products, glass and glass products under Group 3). Table III, "Agricultural and Construction Equipment Index Factors," contains schedules for agricultural and construction equipment.

The commercial equipment index factors table was compiled based on equipment price level change data published by the Marshall Valuation Service. The tables entitled “Industrial Machinery and Equipment Factors” and the “Agricultural and Construction Equipment Index Factors” were derived by Board staff using the Bureau of Labor Statistics producer prices and price index as a basis.

In addition, the equipment percent good factors found in Table V are based upon the logical premise and accepted appraisal principle that the value of a property is equal to the present worth of its anticipated future net benefits. These factors are intended to reflect the average loss in value that commercial and industrial equipment, in general, will suffer over a period of time. The factors are based upon averages and represent a reasonable estimate of the percent good of typical items of equipment.

AH 581 is designed to assist the county appraisers in estimating the fair market value of equipment. The handbook is to be used by selecting a specific equipment index factor from among the 20 equipment categories and then applying the appropriate percent good factor to arrive at an estimate of RCNLD. It is not intended to be used as a single price index, nor is it to be applied by averaging the various industry classes.

RECOMMENDATION 6: Improve the processing of business property statements by: (1) using the Board’s equipment index and percent good factors as recommended in the AH 581; (2) applying the equipment index factors uniformly within similar business types; (3) screening the property statements for authorized signatures; and (4) following the policy to purge old data from business property files.

#### Use Board Index and Percent Good Factors

The Santa Clara County business property division continues to use a single price index factor for commercial equipment and a single price index factor for industrial equipment. This was addressed in our last assessment practices survey. The staff determines an arithmetic average for the 12 commercial classes and the 6 industrial classes. This average index factor is applied to all equipment in the respective class to determine the replacement cost new (RCN) of individual property items. The RCN is then multiplied by the percent good factor to arrive at the replacement cost new less depreciation (RCNLD).

We again make the same recommendation as that made in our last assessment practices survey. We recommend that the assessor use the appropriate price index factor for each category of equipment. Averaging commercial, industrial, agricultural, and construction indexes sacrifices accuracy and results in incorrect assessments for most taxpayers.

#### Apply Equipment Index Factors Uniformly

One of our recommendations in the last assessment practices survey of Santa Clara County involved the issue of consistency in applying index factors uniformly within the

same business type. For this survey, we reviewed numerous business property statements belonging to three major business classification codes. Our review again showed that there were inconsistencies in the way the county processed the randomly selected property statements. The inconsistencies ranged from differing economic lives to differing percentage splits between personalty and fixtures, or no fixture allocation at all.

Standardization and consistency in the application of index factors are essential for effective, efficient, and equitable assessments among taxpayers. The selection and uniform application of the appropriate index factors are important steps in the equalization process.

The assessor in his response to our above recommendation stated that:

Annually, prior to the processing season, we conduct a refresher training session with the processing staff. This training is intended to reduce to the lowest possible level, errors such as type described. However, human errors will occur and on occasion class codes or economic lives will be incorrect. As a further check, it is a standard procedure to verify the coding, lives and index factors at the time of audit.

While we currently print the assigned class code on the Business Property Statement, in the future we will also be pre-printing the related economic life, in an effort to provide an additional check at the time of processing.

We commend the Santa Clara County Assessor's Office for conducting an annual training session with the processing staff. It is one of the few counties that have this kind of program, and it is essential for this county, considering the high number of large commercial and industrial companies located in it.

The assessor's standard procedure of verifying the coding, lives, and index factors at the time of audit is effective only for those accounts belonging to the mandatory audit threshold of \$300,000 or more. It is quite limited in its effectiveness for nonmandatory accounts since the business property division has a very limited nonmandatory audit program.

We recommend that the assessor's managers and supervisors exercise more prudent oversight to ensure consistency among the audit-appraisal staff, particularly in the selection and application of index factors for personal property and fixtures. This can be facilitated by the assessor implementing the plan for pre-printing the related service life on the business property statements. This should minimize clerical errors committed in processing business property statements.

### Screen the Property Statements for Authorized Signatures

Section 172 of Title 18 of the California Code of Regulations (Property Tax Rule 172) requires that business property statements “when signed by an agent or employee other than a member of the bar, a certified public accountant, a public accountant, an enrolled agent, or a duly appointed fiduciary, the assessee’s written authorization of the agent or employee to sign the statement on behalf of the assessee shall be filed with the assessor. . . . The assessor may at any time require a person who signs a property statement and who is required by this section to have written authorization to provide proof of his authorization.” Subdivision (b) of Property Tax Rule 172 provides that “in the case of a corporate assessee, the property statement and mineral production report shall be signed by an officer or by an employee or agent whom the board of directors has designated in writing (other than those excepted in paragraph (a) above), by name or title, to sign such statements on behalf of the corporation. . . . A record of the written authorization on the appointment and the designation required by this subsection shall be retained by the assessee for a period of six years from the date of its execution.” In addition, subdivision (d) of Property Tax Rule 172 provides that “Neither the assessor nor the board shall knowingly accept any signed property statement or mineral production report that is not executed in accordance with the requirements of this section.”

In our review of business property statements, we found several statements signed by the assessee’s agent without the required written authorization on file.

By requiring such written authorization to be filed, an assessor will increase the accountability of whoever signs and files the annual property statement. The corporate assessee will realize that the filing agent or employee is given, by the corporation, the responsibility and the important duty of accurately and fully reporting all assessable business property to the assessor. The written authorization calls attention to the fact that the corporate assessee is liable for any consequences of the employee’s or agent’s errors in reporting.

We recommend that the assessor require, and keep on file, a letter of authorization for those who sign the business property statements other than the assessee, or a member of the bar, a certified public accountant, a public accountant, an enrolled agent, or a duly appointed fiduciary as required by Property Tax Rule 172.

### Purge Old Data From the Business Property Files

The assessor has a policy for purging the business property files. However, we found that a large number of files contained obsolete property statements, miscellaneous correspondence, and other papers that have accumulated for more than ten years.

Section 465 provides for the destruction of any document containing information obtained from taxpayers when seven years have elapsed since the lien date for the taxes for which such information was obtained. Therefore, all property statements and miscellaneous documents for 1989 and prior could be destroyed on or after March 1, 1996.

We recommend that the staff follow the policy to annually purge the business files of those property statements and miscellaneous records more than seven years old. Purging unnecessary and excess paperwork will create additional filing space and make it easier to locate information within individual files.

#### E. PROPERTY DISCOVERY

The timely discovery of taxable property is one of the basic functions of an assessor's office. It is also a continuing process whose difficulty is accentuated by the volatility of many small businesses. It is a formidable task to maintain accurate, up to date listings of assessable business properties. It is, therefore, imperative that an efficient and effective discovery program be in place.

Some sources of discovery include field canvasses, lists of lessees and sublessees from landlords, telephone directories, business licenses, newspapers, referrals from other counties, and sales tax permit cards. Regardless of the method used, a successful discovery program can be achieved only through consistent and methodical application.

For the past 23 years, field canvass has been the primary source of discovery used by the business property division. Canvassing of the whole county is conducted from December to February, or about three months annually, by more than 20 data collectors. The data collectors are not auditor-appraisers but employees hired temporarily for the specific purpose of doing field canvass. While in the field they are supervised by three senior auditor-appraisers.

Field canvass is supplemented by the use of the following:

- (a) Business directory services
- (b) SBE's annual listing of pollution control equipment financing bonds
- (c) SBE Valuation Division Form 600-B
- (d) Referrals from real property division.

For the 1997 lien date the business property division chief and her assistant decided to revise the discovery program for their division. Starting in 1997, the main source of discovery shifted from field canvass to use of the Board's sales tax permit cards. This source of discovery, however, is still augmented by those previously described. The division chief is also looking at the possibility of utilizing the county's data base of fictitious business name filings. She is also requesting an updated listing of lessees and sublessees from all landlords engaged in business within the county. Another source of information that she is trying to access is the data base for the city and county business licenses.

This change is quite significant in many respects. It is the first overhaul of the assessor's discovery program in decades. Data collectors are paid less than auditor-appraisers but more than entry level clerks. The reduction in data collector staffing is a significant amount of money savings. The three senior auditor-appraisers that were used as supervisors for these data collectors should have a big impact on the number of audits the assessor's office will be

producing in the future. The enormous data base established by past countywide field canvassing will make the transition easier for the assessor's office.

We commend the business property division chief and her assistant for their relentless efforts devoted to improving the operation of the business property division. In addition, we commend them on their openness to new ideas and changes for a better and more effective organization.

#### F. DIRECT BILLING

Many California counties utilize an assessment procedure called "direct billing" or "direct assessment." It is a method of assessing the property of qualified small business accounts without the annual filing of a business property statement. An initial value is established and continued for several years, with property statement filings required only periodically.

Section 441 as amended by Chapter 1087 of the Statutes of 1996 (Senate Bill 1827) provides that each person owning taxable personal property, other than a manufactured home, having an aggregate cost of \$100,000 or more shall file a property statement with the assessor. This change became effective January 1, 1997 for the 1997-98 and subsequent tax years. Prior to this amendment the law provided a \$30,000 threshold for the initial tax year or a \$100,000 threshold for subsequent years.

Direct billing is best suited for accounts of less than \$100,000. Most counties, including Santa Clara, have a large number of small, stable businesses that lend themselves to a direct billing program. Examples of these types of businesses include apartments, barber shops, beauty parlors, coin-operated laundrettes, small cafes, restaurants, and professional firms with small equipment holdings.

#### SUGGESTION 8: Expand the direct billing program.

The assessor's office has a direct billing program that is very limited in scope. This program applies only to apartment houses meeting the following criteria:

- (1) Cannot be a new apartment
- (2) Cannot be a "failure to file" account
- (3) Cannot be an "insufficient to assess" account
- (4) Cannot have more than 50 units

Because of this limited application, the direct billing program enrolled only about 1,285 apartment houses. This represents less than 2 percent of the 72,000 business property accounts that were processed and enrolled for the 1996/97 fiscal year. There is a problem with the way the assessor's staff process the returned property statement. This will be discussed in the apartment personalty section of this report.



The direct billing assessment procedure is mutually beneficial to the taxpayer and the assessor. Direct billing streamlines the filing requirements by reducing the amount of paperwork for small businesses. This translates into a reduction in the number of property statements that must be processed by the assessor's staff, culminating in more time available for the auditor-appraisers to conduct audits.

To have a significant impact on the number of property statements processed annually and to take advantage of the cost-saving benefits of the direct billing program, we suggest that the assessor expand his direct billing program to include other qualified small business accounts.

## G. SPECIFIC PROPERTY TYPES

### 1. Leased Equipment

One of the responsibilities of the business property division is the discovery and assessment of taxable leased equipment. The annual business property statement requires that taxpayers report all leased equipment (taxable property in their possession but belonging to others). The name and address of the owner, the month and year of acquisition, the acquisition cost, and other relevant information are requested on the property statement. When leased equipment is reported by the lessee on the property statement, the leasing section support staff checks the list of lessors to see if the leasing company is an active account that would routinely receive a property statement. If the leasing company is not an active account, the lessor is sent the necessary forms and asked to file a property statement.

We reviewed the process used in assessing leased equipment and found that the program is well managed. The procedures in place for the discovery, mailing, processing, and reviewing of leased equipment are effective and satisfactory. However, we have two suggestions to further enhance the program.

SUGGESTION 9: Revise the leased equipment assessments by: (1) annually reviewing the Board's listing of property leased to state assessees; and (2) ensuring that leased equipment retained by the lessee when the lease expires continues to be assessed.

### Property Leased to State Assesseees

Public utilities and railroads in California are assessed by the Board of Equalization's Valuation Division. Certain equipment, used by these assesseees but leased from others, is to be locally valued and assessed by the county assessor. The assesseees report this property to the Valuation Division on Form 600-B. The Valuation Division sends copies of Form 600-B to every county assessor. The form lists equipment leased by public utilities and railroads that is nonunitary in nature and therefore locally assessable by the county assessor. The purpose of Form 600-B is the discovery of leased property that might not otherwise be enrolled. These

forms provide an additional source of verification to determine if lessors and lessees are reporting accurately. The assessor's staff does not process Form 600-Bs.

In the previous survey, we recommended that the assessor's staff annually process these forms. The staff still spends very little time on Form 600-Bs and notes that most of the individual items qualify for exemption under the county's low-value ordinance. The staff believes that their limited time available off-season is used more productively for tracing leased equipment reported on lessee's property statements (Form 571-L) but not reported by lessors. Our review of the Form 600-Bs confirms that a large number of the individual items are pagers, water coolers, and other low cost items. It would not be cost-effective to spend much time on these items unless a large number were found to have escaped assessment and they were assessable to a single entity.

We suggest that the assessor's staff review the Form 600-Bs to ensure which of the lessors appearing on the form are included on the county's active list of lessors. For those that are not, the staff should send a business property statement to the lessor. We also suggest that the Form 600-Bs be scanned for large dollar items and that a reasonable number of these be traced to the various lessors' property statement to determine if they have been included in the lessor's reporting.

#### Leased Equipment Retained by Lessee

When property is on lease, the lessor should report such property on the annual property statement. When the lease terminates, the lessor usually stops reporting the equipment.

The leasing unit spends all available post-season time answering inquiries from taxpayers, correcting names, addresses, and lessor and lessee reporting errors, and following up on leased equipment reported by lessees for which there has been no lessor reporting. This follow-up activity has been productive in enrolling additional assessments.

Our review indicated that the county does not assess the property once the lease is terminated unless the lessee begins reporting the formerly leased equipment as part of owned equipment. The lessee may keep the equipment or return it to the lessor. When lessees assume ownership of the formerly leased equipment, it is often not reported and thus it escapes assessment. Other counties compare the current year's report with the previous year's report to identify items that have dropped off the listing. This starts the process of determining the status of off-lease equipment and identifying possible escapes. Once identified, items can be traced to appropriate records and further action taken when necessary.

We suggest that a procedure be implemented to more closely track the disposition of leased equipment on which the lease has expired or been terminated.

## 2. Apartment Personality

Landlord-owned personal property in apartment complexes is assessable and reportable on the annual "Apartment House Property Statement," Form 571-R. Such personal property includes, but is not limited to, refrigerators, freestanding electrical stoves, gym equipment, pool equipment, laundry equipment, maintenance equipment, office furniture, and common area furniture.

The business property staff assessed approximately 1,988 apartment house accounts for the assessment roll 1996-1997. There were 11 unsecured apartment house accounts with a total full value of \$322,036. The remaining 1,977 accounts with a full value of \$33,907,048 were those apartment house accounts enrolled on the secured assessment roll.

In 1996 the business property division chief, on instruction by the assessor, issued a memorandum changing the processing and valuation of apartments. The assessor instituted the following procedures in processing and valuing the personal property in apartments:

- (1) apartment houses of 15 or fewer units will no longer be sent property statements.
- (2) apartment houses of 16 to 50 units will receive property statements once every four years and the annual personal property assessment will be based on information contained in the first year of filing a property statement.
- (3) apartment houses of 51 or more units will be assessed based on the property statements filed annually.

RECOMMENDATION 7: Revise the assessment of personal property in apartments by: (1) basing the assessment on information provided on the apartment house property statements; and (2) correctly applying the low-value ordinance.

### Assessment Based on Information on the Apartment House Property Statements

Apartments with 16 to 50 units are in the direct billing program. Under this program, the assessor's office sends an Apartment House Property Statement (571-R) to owners of apartments with 16 to 50 units. If the 571-R is returned timely, a full cash value for the personal property is determined. After the initial year, the staff sends a property statement once every four years to update their information. Non-filers are mailed a property statement every year until the assessor's office receives a timely filing.

However, the assessor's staff does not use the cost information provided in the property statement to assess the personal property. Instead, if the property owner states that there is no personal property, then no assessment is made for personal property. If the statement provides that the units are partly or fully furnished, then the business property staff levies an

arbitrary amount of \$250 for a refrigerator for every partially and fully furnished apartment. For each ten units, \$300 is added to cover the value of laundry equipment. In addition, larger apartment complexes are assessed an additional amount of \$500 to \$1,000 for supplies and \$1,000 to \$5,000 for swimming pool equipment, pool furniture, exercise, office, and maintenance equipment.

Out of the 1,988 apartment house accounts enrolled in the 1996-1997 assessment roll, 1,285 or 65 percent were assessed by direct billing method. This means that 1,285 apartment house accounts were assessed based on the 1995 full cash value which was determined by using the old procedure of making an arbitrary assessment as described in the previous paragraph.

When the owner reports costs on the property statement, the reported costs should be used. If reported costs vary from the arbitrary values used by assessor's staff, property is incorrectly valued either as over or under assessments.

We reviewed and recalculated the full value of several apartment house accounts. We calculated an RCNLD based on the original costs reported by the assesseees in their apartment house property statements and compared these RCNLD with the 1996 enrolled full value. In one of the 13 randomly selected apartment house accounts, the county's full value is lower than our RCNLD, while the remaining 12 apartment house accounts had a full value higher than our RCNLD.

We recommend that the assessor instruct the business property staff to follow the new procedure contained in his recent memorandum on the assessment of personal property for apartment houses consisting of 16 to 50 units. The valuation of personal property in apartments should be based on the information provided in the property statements; the results should be used as the basis for the direct enrolled full cash value. An assessment based on the information provided in the property statement is more accurate and equitable than an assessment that is automatic and arbitrary.

#### Apply the Personal Property Exemption Correctly

As previously stated, one of the changes made for assessing apartments is that owners of apartment with 15 or fewer units will no longer be sent a property statement nor be assessed for personal property.

On October 3, 1995, the Santa Clara County Board of Supervisors enacted Ordinance Number 220 exempting low-value personal property up to the full value amount of \$2,000.

Section 155.20 authorized county boards of supervisors to exempt from property tax real property with a base year value and personal property with a full value so low that, if not exempt, the total taxes, special assessments and applicable subventions on the property would amount to less than the cost of assessing and collecting them. It also provides that the county

board of supervisors shall have no authority to exempt property with a total base year or full value of more than \$5,000 except enumerated possessory interests

Since Santa Clara County has a low value ordinance of only \$2,000, the assessor has no authority to exempt from taxation any property that has a full value of greater than \$2,000. We identified more than 50 apartment house accounts having 15 or fewer units and personal property with a full cash value of more than \$3,000 each. This shows that exempting the personal property of apartments with 15 or fewer units is contrary to the county's ordinance on low value property.

We recommend that the business property division modify their existing practice of exempting the personal property of apartment houses with 15 or fewer units. Instead, assessor's staff should follow their low value ordinance and let the maximum amount of the ordinance be the controlling factor and not the number of units of an apartment complex.

### 3. Leasehold Improvements

Leasehold improvements are real property items that are owned and installed by a lessee on leased real property. Typically, leasehold improvements are found in retail stores or office buildings. Leasehold improvements may also be known as foreign improvements. Because the owner of the leasehold improvements does not own the total real property at a location, discovery by the assessor's staff of leasehold improvements may be difficult.

Assessment of leasehold improvements is a complex procedure involving detailed documentation for proper tracking of base years and ownership. Close cooperation between the business property division and the real property division is essential to avoid incorrect assessments.

The most common methods of discovery for leasehold improvements are the building permits that are processed by the real property division and the business division's annual business property statements (Form AH 571). A section of the business property statement deals specifically with real estate owned by the occupants of premises housing business enterprises. Such taxpayers are annually required to list additions or deletions of real property.

The business property division discovers leasehold improvements either while processing the annual business property statements or in the course of normal audit work. Using referral form 9154, staff notifies the real property division of items that the business property division will not assess unless otherwise directed to do so.

In working permits, the real property appraisers determine whether a portion of permitted construction should be assessed by the business property division. Then, using referral form 8526 they notify the business property division that permitted construction may contain cost components such as personal property or fixtures. Both referral forms require signed acceptance by an appraiser.

RECOMMENDATION 8: Revise the assessment of leasehold improvements by: (1) improving the response system to ensure coordination between the business and real property divisions; and (2) ensuring that all leasehold improvements are treated uniformly.

#### Positive Response System

The volume and timing of incoming business statements often makes coordination between the real property and business property divisions difficult. Also, many property owners and lessees erroneously list costs as structural items when they were actually expended on items that are not considered to be assessable new construction.

The assessor's office procedures require coordination between the real property and business property divisions to determine assessability and allocation of reported costs between the two divisions. However, the current practice is for the business division to inform the real property division only of taxpayer reported structural costs that exceed \$100,000. The business division enrolls all reported structural costs below that amount without notifying the real property division. This minimizes the possibility of escaped assessments because it causes most structural declarations to be assessed.

However, taxpayers often make errors when characterizing expenditures as structures or fixtures on the business property statement, which increases the risk for escaped assessments, misclassification of new construction, double assessments, or erroneous assessment of normal maintenance and repair costs as new construction. In our review we also found instances where the business property division enrolled declared costs for undefined structure items substantially higher than \$100,000 without informing the real property division.

Double assessments can also result when the business division enrolls structural costs without notifying the real property division. Both divisions may enroll the same structural improvements if the real property division also assesses them upon separate discovery of construction activity.

Whenever structural changes are reported on the Schedule B of a property statement, a copy should be attached to the referral form and sent to the real property division for analysis. The business division should track the referral until the real property division completes its inspection and notifies the business division of its assessment intentions. We recommend that this notification, as well as the property statement reporting structural costs, be included in both business property and real property records.

We recommend that the assessor's office improve the response system of coordination. The resulting flow of information between the real property and business property divisions with attendant documentation ensures tracking, proper segregation, and continuity in the recording of assessable leasehold improvements and structural additions.

### Treat All Leasehold Improvements Uniformly

The assessor's current procedure is to apply a 15-year service life to all structural improvements with reported cost below \$100,000 on Schedule B of the business property statement. This practice applies to structural improvements. For those over \$100,000 the business property division makes a referral to the real property division with the assumption that the real property division will be assessing such improvements.

The county's rationale for assigning a 15-year service life is that these types of structural improvements relate to the manufacturing process of the user instead of the building's useful life. This was the same answer the assessor gave us when he responded to recommendation 7 in our assessment practices survey dated October 1995.

The assessor stated, "Leasehold improvements are generally improvements made to a structure by the tenant and are intended to facilitate the use of the real property in the economic pursuits of the tenant." He continued by stating, "In some cases the leasehold improvements, although structure related, are in reality part of the manufacturing process. In other cases, the leasehold improvements are clearly a part of the structure and can be expected to have a life which exceeds the manufacturing process."

While some leasehold improvements are directly related to a specific use of a building, many improvements such as general lighting, heating and cooling, elevators, and office areas are needed for any potential user. The service lives of these types of leasehold improvements are not related to the service lives of the equipment used in the building. These types of leasehold improvements are clearly a part of the structure and can be expected to have a service life exceeding the manufacturing process.

As we have pointed out during our last assessment practices survey, the staff's practice of using a 15-year service life can lead to the undervaluation of leasehold improvements. The use of a 15-year service life is tantamount to depreciating real property improvements over a relatively short economic life. This in effect will produce a significant valuation difference between similar improvements assessed on real property accounts versus the business property account. Thus, the same leasehold improvements, if assessed on a real property account, would probably not be depreciated at all but would be increasing in taxable value each year under section 51.

We are again making the same recommendation we made in our last assessment practices survey of Santa Clara County. We recommend that the assessor treat all leasehold improvements uniformly with regard to the economic life.

#### 4. Boats and Vessels

The business property division assessed 8,382 boats on the 1996-1997 tax roll with a total assessed value of \$54,092,834. The primary sources of discovery are Department of Motor Vehicles (DMV) reports and referrals from other counties. Our review of the boat assessment program indicated the need to repeat the prior survey recommendation.

##### Appraisal Procedures

RECOMMENDATION 9: Revise boat appraisal procedures by appraising pleasure boats at market value.

The assessor's staff follows accepted boat valuation procedures the first time a boat is entered on the local roll. However, we disagree with the county's continued practice of annually reducing the boats' values by a fixed percentage rather than assessing the boats at market value. The current practice is that once appraised, these values are enrolled and depreciated 5 percent annually in subsequent years. When the depreciated value falls below \$2,000, the craft becomes exempt as authorized by the county's low-value property exemption ordinance.

The arbitrary percentage reduction in value of all pleasure boats is merely an act of administrative convenience substituted for actual market value appraisals. While the overall boat valuation procedure is efficient, the fixed depreciation rate applied to all pleasure boats regardless of type seldom reflects actual boat values. Based on the results of our review, this practice has caused disparities and improper assessments.

Although staff limitations preclude the reappraisal of each vessel on an annual basis, we urge the staff to adopt a valuation approach that better reflects market value. One feasible way to do this would be to select sample vessels from "new" and "used" groups of five classes each (sailboat, inboard, outboard, inboard-outboard, and jet skis). Trends in market values for these groups and classes could be determined by comparing published boat valuation guides for the current and previous years. The county should concentrate on doing this analysis on one group per year. Once trend factors are computed, they should be applied to all boats within each group.

##### DMV's Vessel Database

Owners of pleasure boats are required to register their boats with the Department of Motor Vehicles. This state agency maintains a computer database with owner's name and address, boat type and class, and other pertinent information. When a boat owner sells or moves the boat to a new situs, DMV is notified and updates this database. Periodically the DMV sends these updated reports to the county assessor's offices listing all vessels registered in their particular county.



To facilitate tracking of boat owners and their boat situs, DMV permits assessors' offices to access its database to obtain current information. Having this access to DMV's system saves considerable staff time in determining the location and ownership of pleasure boats. At the time of our survey, the Santa Clara Assessor's Office did not have a computer connection to the DMV database. Without this access, there are considerable delays in determining the correct situs and ownership information on pleasure boats.

The assessor's staff is currently working on getting all the necessary authorizations and approvals for the DMV computer connection. We commend the assessor for taking this step to obtain computer access to the DMV boat database.

#### Staff Utilization

SUGGESTION 10: Redirect nonappraisal duties to the support staff.

The Santa Clara Assessor's present practice of using an auditor-appraiser to process vessel owner reports is a costly misuse of staff resources. The processing of the vessel owner's report could be performed by assessment technicians with minimal training. This will allow the auditor-appraiser to review the vessel calculations made by these support personnel and to handle complicated vessel assessments and vessel appeals.

Although some nonappraisal staff is currently being used, we believe that more of the workload in the boat unit could be shifted to the nonappraisal personnel. We suggest that the auditor-appraiser's duties be adjusted to allow more audits to be performed and the processing of vessel owner reports be assigned to the support personnel staff.

#### 5. Computers

The valuation of computers and related equipment (herein referred to as computers) has been a contested issue between taxpayers and assessors for the last few years. In its continuing effort to maintain proper, equitable, and uniform property tax assessment, the Board, in a Letter to Assessors (LTA) 95/26, dated April 5 1995, recommended valuation factors for assessors to use when valuing non-production computers for the 1995 lien date. These factors were developed after consultation with the computer industry and assessors.

For the 1996 lien date, the Board issued LTA 96/19 (dated March 6, 1996) which contained tables for personal and mainframe computers. LTA 96/27 (dated April 3, 1996) expanded these two tables into three tables, i.e., personal computers (\$25,000 or less), mid-range computers (\$25,000 to \$499,000), and mainframe computers (\$500,000 or more). LTA 96/27 also stated that the Board staff had been instructed to continue acquiring and analyzing data for the mid-range table. No additional data was incorporated into the mid-range table that was set forth in LTA 96/27. However, it is the Board's position that the proper application of the factors would yield a reasonable estimate of current market value of computers for the 1996 lien date.

For the 1997 lien date, the Board issued LTA 97/18 (dated April 2, 1997) containing the new valuation factors for the three tables similar to what were provided in our LTA 96/27. The tables for small computers and mainframe computer systems represent a recalculation of the depreciation curves that were used to calculate values for those categories for the 1996 lien date. The table for mid-range computers represents a new curve based on all data accumulated to date. The Board reviewed all data accumulated by the Property Taxes Department staff, the California Assessors' Association, and representatives of the computer industry. The Board then authorized the publication of the computer valuation tables for the 1997 lien date.

We were assured by the business property division chief that the staff will use our computer valuation tables as recommended for the 1997 lien date. However, no determination of such compliance could be performed yet, as the 1997 business property statement processing season had not begun at the time we finished the fieldwork for this survey.

## 6. Computer Programs

Sections 995 and 995.2 provide for the assessability of computer storage media. Section 995 provides, in relevant part, that:

“Storage media for computer programs shall be valued on the 1972 lien date and thereafter as if there were no computer program on such media except basic operational programs. Otherwise, computer programs shall not be valued for purpose of property taxation.”

Section 995.2 defines basic operational program. It provides, in part, that:

“The term ‘basic operational program’ as used in section 995 ...means a computer program which is fundamental and necessary to the functioning of a computer.”

Property Tax Rule 152 defines how computer programs should be assessed. Subdivision (d) provides, in relevant part, that:

The term ‘basic operational’ program refers to a ‘control program,’ as defined in section 995.2 of the Revenue and Taxation Code, that is included in the sale or lease price of the computer equipment. (Emphasis added.)

The rule goes on to provide, in subdivisions (h)(1) and (h)(2), examples of taxable and non-taxable computer programs.

(1) Included in the price of every IBM and IBM compatible personal computer and every Apple and every Apple compatible personal computer is a basic input output system (BIOS). BIOS is a copyrighted computer program that controls

basic hardware operations, such as interactions with diskette drives, hard disk drives and the keyboard, and that facilitates the transfer of data and control instructions between the computer and peripherals. The operation of other computer programs, such as the various versions of Disk Operation Systems (DOS), Windows, OS/2, UNIX and similar programs, is possible only through the facilities provided by BIOS, but operational programs other than BIOS are not in themselves fundamental and necessary to the functioning of the computer.

(2) Included in the price of the IBM mainframe computers is a license to use IBM's Licensed Internal Code (LIC) on the computer. LIC is a set of copyrighted computer programs (commonly referred to in the computer industry as microcode) that include the programs that implement the basic functions of the mainframe computer and operate the control logic necessary to execute user instructions to the computer. Manufacturers of other computers likewise include in the price of their computers the microcode necessary to implement the basic functions of the computer. The operation of other computer programs is possible only through the facilities provided by microcode, but operational programs other than microcode are not in themselves fundamental and necessary to the functioning of the computer.

Thus, pursuant to Rule 152, it is clear that only basic operational programs, such as BIOS or microcode, are assessable. BIOS or microcode is included with a new computer since the computer cannot function at all without it. Although it is possible for a computer's original BIOS or microcode to be replaced, such replacements are relatively rare; virtually all purchases of computer programs are for enhanced applications and are not taxable.

RECOMMENDATION 10: Revise the procedures for assessing computer programs by (1) assessing only basic operational programs; (2) establishing criteria for assessing computer software; and (3) explaining in the audit narrative and other workpapers the basis for assessing basic operational programs.

### Basic Operational Programs

We reviewed 33 audits of companies that made purchases of computer programs. In the majority of cases, the assessor made no assessments of computer programs. However, in two cases the taxpayers were assessed for computer programs, and in several other cases it was difficult to determine from the audit narratives or workpapers whether or not computer programs were assessed.

In the cases where software was assessed, some of the taxpayers supplied lists stating that these were applications programs. None of the listings provided any indication that the programs were taxable basic operational programs (BIOS or microcode), and there was no

documentation in the assessor's audit workpapers to support a conclusion that the programs were taxable.

It is obvious that the computer programs assessed were application programs and not basic operational programs. These assessments of computer software were few and relatively small in relation to the total property, but nevertheless they should not have been made. Accordingly, we recommend that the assessor follow the clear direction provided in section 995 and Rule 152 and not assess computer programs, except the basic operational programs.

#### Assessment Criteria

At the time the assessments were made, the staff did not have written instructions or criteria to consider regarding the assessability of computer programs. It is our understanding that the staff was originally given verbal instructions regarding computer software and recently received written instructions. Written instructions help provide a clear definition of basic operational programs for the staff. The instructions should require that any assessments of computer programs must be supported by clear documentation demonstrating that the computer programs are basic operational programs as defined by Rule 152.

We recommend that the assessor develop written criteria to the audit staff concerning the determination of basic operational programs and their assessability.

#### Audit Narratives and Workpapers

The comments in the audit narratives and workpapers of the reviewed audits did not include any discussion as to whether the assessed computer programs consisted of taxable BIOS or microcode. In fact, in most cases, there was very little detail regarding the assessment of the computer programs. Since virtually all computer programs purchased separately from the original purchase of a computer are not basic operational programs, we believe that any assessments of computer programs should contain clear documentation that demonstrates that the programs are in fact assessable, i.e. BIOS or microcode.

We recommend the assessor direct the business property staff to provide adequate details in the audit narrative and other workpapers when a basic operational program as defined by Rule 152 is assessed.

## THE ASSESSMENT SAMPLING PROGRAM

The need for compliance with the laws, rules, and regulations governing the property tax system and related assessing<sup>3</sup> activities is very important in today's fiscally stringent times. The importance of compliance is twofold. First, the statewide maximum tax rate is set at 1 percent of taxable value. Therefore, a reduction of local revenues occurs in direct proportion to any undervaluation of property. (It is not legally allowable to raise the tax rate to compensate for increased revenue needs.) Secondly, with a major portion of every property tax dollar statewide going to public schools, a reduction in available local property tax revenues has a direct impact on the State's General Fund, which must backfill any property tax shortfall.

The Board, in order to meet its constitutional and statutory obligations, focuses the assessment sampling program on a determination of the full value of locally taxable property and eventually its assessment level. The purpose of the Board's assessment sampling program is to review a representative sampling of the assessments making up the local assessment rolls, both secured and unsecured, to determine how effectively the assessor is identifying those properties subject to revaluation and how well he/she is performing the valuation function.

The assessment sampling program is conducted by the Board's County Property Tax Division (CPTD) on a five-year cycle for the 11 largest counties and cities and counties and on either a random or as-needed basis for the other 47 counties. This sampling program is described as follows:

- (1) A representative random sampling is drawn from both the secured and unsecured local assessment rolls for the county to be sampled.
- (2) These assessments are stratified into 18 value strata (nine secured and nine unsecured).<sup>4</sup>
- (3) From each stratum a random sampling is drawn for field investigation, sufficient in size to reflect the assessment level within the county.

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<sup>3</sup> The term "assessing" as used here includes the actions of local assessment appeals boards, the boards of supervisors when acting as boards of equalization, and local officials who are directed by law to provide assessment-related information.

<sup>4</sup> The nine value strata are \$1 to \$99,999; \$100,000 to \$199,999; \$200,000 to \$499,999; \$500,000 to \$999,999; \$1,000,000 to \$1,999,999; \$2,000,000 to \$19,999,999; \$20,000,000 to \$99,999,999; \$100,000,000 to \$249,999,999; and \$250,000,000 and over.

- (4) For purposes of analysis, the items will be identified and placed into one of five categories after the sample is drawn:
- a. “B” (base year) properties. Those properties the county assessor has not reappraised for either an ownership change or new construction during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling.
  - b. “T” (transferred) properties. Those properties last reappraised because of an ownership change that occurred during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling..
  - c. “C” (new construction) properties. Those properties last reappraised to reflect new construction that occurred during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling.
  - d. “N” (non-Proposition 13) properties. Those properties not subject to the value restrictions of article XIII A, or those properties that have a unique treatment. Such properties include mineral-producing property, open-space property, timber preserve property, and taxable government-owned property.
  - e. “U” (unsecured) properties. Those properties on the unsecured roll.
- (3) From the assessment universe in each of these 18 value strata (nine strata on both secured and unsecured local rolls), a simple random sampling is drawn for field investigation which is sufficient in size to reflect the assessment practices within the county. A simple nonstratified random sampling would cause the sample items to be concentrated in those areas with the largest number of properties and might not adequately represent all assessments of various types and values. Because a separate sample is drawn from each stratum, the number of sample items from each category is not in the same proportion to the number of assessments in each category. This method of sample selection causes the raw sample, i.e., the "unexpended" sample, to overrepresent some assessment types and underrepresent others. This apparent distortion in the raw sampling is

eliminated by "expanding" the sample data; that is, the sample data in each stratum are multiplied by the ratio of the number of assessments in the particular stratum to the number of sample items selected from the stratum.

Once the raw sampling data are expanded, the findings are proportional to the actual assessments on the assessment roll. Without this adjustment, the raw sampling would represent a distorted picture of the assessment practices. This expansion further converts the sampling results into a magnitude representative of the total assessed value in the county.

- (6) The field investigation objectives are somewhat different in each category, for example:
- a. Base year properties -- for those properties not reappraised during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling: was the value properly factored forward (for the allowed inflation adjustment) to the roll being sampled? was there a change in ownership? was there new construction? or was there a decline in value?
  - b. Transferred properties -- for those properties where a change in ownership was the most recent assessment activity during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling: do we concur that a reappraisal was needed? do we concur with the county assessor's new value? was the base year value trended forward (for the allowed inflation adjustment)? was there a subsequent ownership change? was there subsequent new construction? was there a decline in value?
  - c. New construction -- for those properties where the most recent assessment activity was new construction added during the period between the lien date five years prior to the roll currently being sampled and the lien date of the current sampling: do we concur that the construction caused a reappraisal? do we concur with the value enrolled? was the base year amount trended forward properly

(for the allowed inflation adjustment)? was there subsequent new construction? or was there a decline in value?

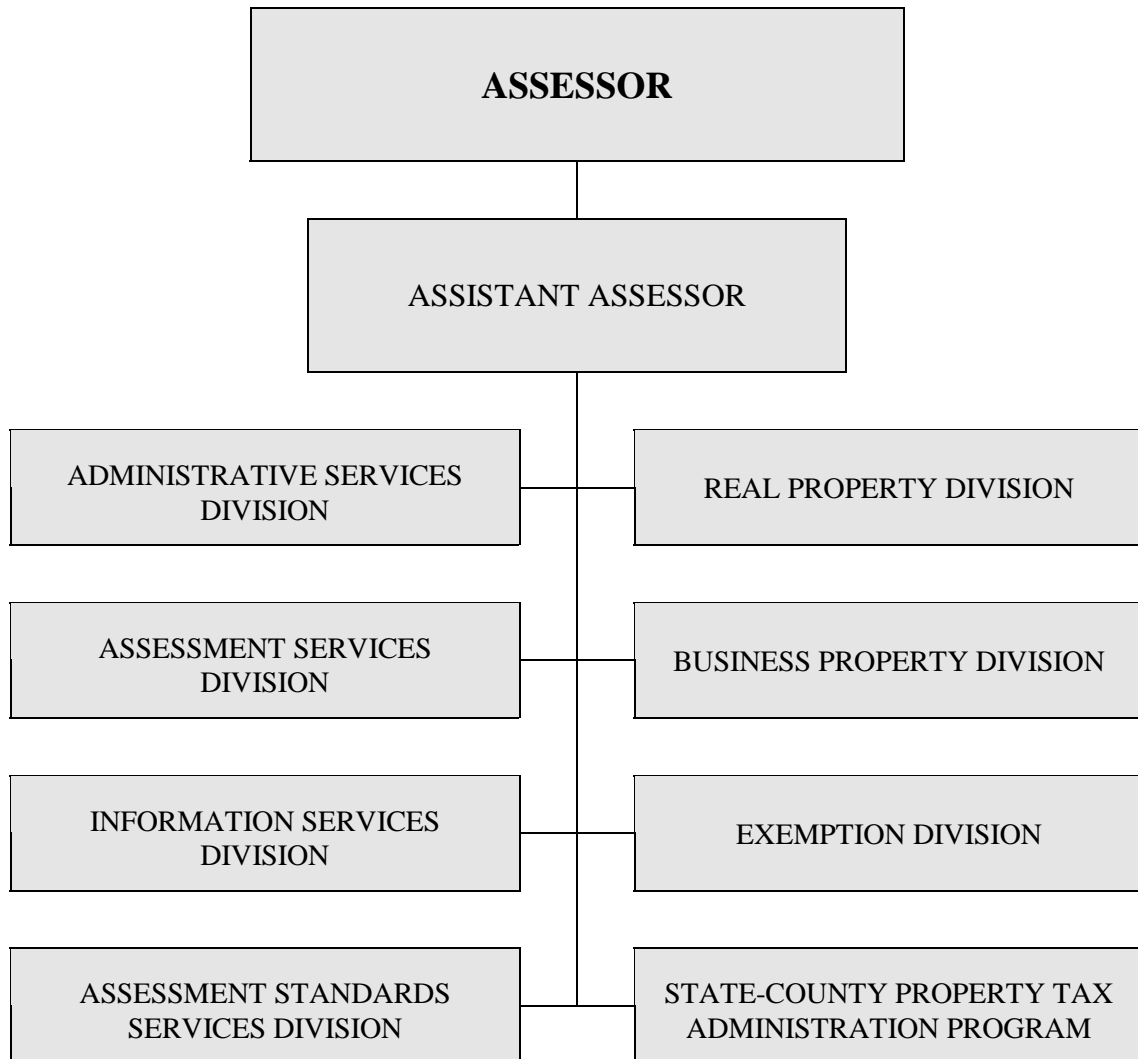
- d. Non-Prop 13 properties -- for properties not covered by the value restrictions of article XIII A, or those properties that have a unique treatment, do we concur with the amount enrolled?
  - e. Unsecured properties -- for assessments enrolled on the unsecured roll, do we concur with the amount enrolled?
- (7) The results of the field investigations are reported to the county assessor, and conferences are held to review individual sample items whenever the county assessor disagrees with the conclusions.
  - (8) The results of the sample are then expanded as described in (5) above. The expanded results are summarized according to the five assessment categories and by property type and are made available to the assessment practices survey team prior to the commencement of the survey.

One of the primary functions of the assessment practices survey team is to investigate areas of differences disclosed by the sampling survey data, determine the cause and significance of the differences, and recommend changes in procedures that will reduce or eliminate the problem area whenever the changes are cost effective or are required by legal mandate. Consequently, individual sample item value differences are frequently separated into segments when more than one problem is identified, and the results expanded and summarized according to the causes of the differences. Much of the support for the County Property Tax Division's recommendations in the form of fiscal and numerical impact is drawn from the expanded sample data, and statistics relating to specific problems have been incorporated in the text of this report.

Emphasis is placed on factors directly under the county assessor's control. Differences due to factors largely beyond the county assessor's control, such as (1) conflicting legal advice, (2) construction performed without building permits, (3) unrecorded transfer documents, (4) assessment appeals board decisions, and (5) factors requiring legislative solution are specifically identified in the text when these problems are reflected in the statistics.



**SANTA CLARA COUNTY  
OFFICE OF THE ASSESSOR  
ORGANIZATION CHART**



ASSESSOR'S

RESPONSE

TO

BOARD'S

RECOMMENDATIONS

# County of Santa Clara

Office of the County Assessor

County Government Center, East Wing  
70 West Hedding Street  
San Jose, California 95110-1771  
(408) 299-4347 FAX 298-9446



Lawrence E. Stone, Assessor

September 10, 1998

Richard C. Johnson, Deputy Director  
Property Taxes MIC: 63  
State Board of Equalization  
450 N Street  
Sacramento, CA 95814

Dear Mr. Johnson:

Enclosed is my response to the recommendations contained in the State Board of Equalizations' Assessment Practices Survey (audit) of the Assessor's Office, pursuant to Section 15645 of the California Government Code. The SBE audit provides an independent and professional examination of the assessment practices and procedures in my office. I am gratified to know that they conform to the highest professional standards.

As the independently elected Assessor for Santa Clara County, the California State Constitution holds me directly responsible for the accurate, timely and efficient production of the annual assessment roll. Similarly, the State Board of Equalization performs a vital "oversight" role which is met, in part, by the comprehensive Assessment Practices Survey. The SBE's oversight responsibility is designed to protect the integrity of the property tax system and insure the confidence of both the taxpaying public and government agencies who benefit directly from the revenue generated by accurate assessments.

Effective administration of the assessment function is of critical importance to local government. In Santa Clara County, the property tax system generates in excess of \$1.4 billion for schools, cities, the county, redevelopment agencies and special districts. Moreover, the State Board of Equalization has a unique authority to levy significant financial sanctions if an Assessor fails to meet an established compliance standard. This statutory requirement sets a 95% compliance ratio as the threshold to continue to collect the administrative costs of supplemental assessments. This reimbursement to Santa Clara County totaled \$1.3 million in 1996-97. The fact that your survey team concluded that our office not only met the 95% compliance ratio, but achieved a total ratio of 98.6%, is a tribute to the dedication and professional competence of our entire staff.

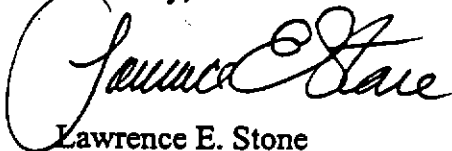
As county Assessor, I am gratified that the SBE survey team praised our appraisal staff as being "highly motivated, competent and professional." Of particular significance was your observation that the "business property assessment program is one of the best we have reviewed." I was pleased that the survey team acknowledged the numerous changes and substantial improvements in our operation since your last Assessment Practices Survey published in 1995. The 1998 Santa Clara County Grand Jury report rendered a commensurate evaluation of our assessment practices with respect to the procedure followed in restoring assessments of "Proposition 8" properties.

I sincerely appreciate the constructive analysis of our operations and recommendations for improvement. You will note that we have already addressed and resolved many of the recommendations cited in the report.

In other areas, we must continue to evaluate our financial and personnel resources to ensure that they are utilized in the most efficient and productive manner possible. In response to the 1995 Assessment Practices Survey, I indicated that we must improve the way we prioritize our responsibilities and direct declining resources, human and financial, where they will generate the highest beneficial return on our public investment. I was elected with a mandate to streamline public operations, in addition to the design and implementation of a performance-based management system that insures the prudent allocation of public resources to prevent the "expenditure of a dollar to collect a dime".

In conclusion, I wish to express my appreciation to you and the survey team for the professional manner in which the survey was conducted, with a minimum of disruption to our operations. Their cooperative attitude and constructive comments throughout the process is acknowledged by all members of my management team.

Sincerely,

A handwritten signature in cursive script, appearing to read "Lawrence E. Stone".

Lawrence E. Stone  
Assessor

Attachment

**Santa Clara County Assessor's Response  
To  
State Board of Equalization Recommendations  
1998**

**RECOMMENDATION 1:**

*Obtain bond information from the tax collector and auditor-controller's offices.*

**BACKGROUND:**

Improvement bonds are a form of public financing usually associated with land improvements such as roads, schools, and utility services that generally enhance land value. The existence of improvement bonds may influence the sales price of a property, and, therefore, the sales price may or may not reflect the property's true market value. Appraisers should account for improvement bonds when evaluating the sale price or when selecting comparables in areas where improvement bonds are utilized.

**RESPONSE:**

Our appraisal staff does adjust the sale price of these properties when we are aware that improvement bonds exist. Improved coordination with the Auditor/Controller's Office has been established to increase the identification of parcels encumbered by improvement bonds. We anticipate that the Tax Collectors' future computer system will enhance the transmission of the data between departments including parcels with improvement bonds.

**RECOMMENDATION 2:**

*Adjust taxable values only when the change can be supported from market data.*

**BACKGROUND:**

Property values in Santa Clara County peaked in 1989-90, and subsequently began a steady decline. The Santa Clara County Assessor proactively recognized the decline in market values and utilized mass appraisal techniques to temporarily reduce assessments accordingly, beginning in 1991. During 1995, market values of effected properties began to improve. In 1996 the Assessor began restoring assessments on properties previously reduced under Proposition 8.

**RESPONSE:**

It is our continued policy to adhere to the provisions of Section 51(a)(2) and 51(e) when reducing or restoring values whether utilizing either an individual or mass appraisal approach. The enrollment of the 1.11% annual factor on previously reduced commercial and industrial properties in 1996 was the result of an in-house market survey which supported some marginal restoration of value on commercial / industrial properties within the county.

### **RECOMMENDATION 3:**

*Revise the CLCA program by: (1) assessing trees and vines; (2) using animal unit months (AUM's) as the unit of measurement in assessing grazing land; (3) deducting a charge from the income stream for return on and return of investment in nonliving improvements; (4) deducting a capital replacement charge for irrigation wells; and (5) incorporating the current market value test for determining market value.*

### **BACKGROUND:**

The intent of the California Land Conservation Act (CLCA) is to retain land in its agricultural state in return for a valuation/assessment procedure, which recognizes its agricultural or open space use.

### **RESPONSE:**

Santa Clara County is a highly urbanized County. Approximately one-tenth of one percent (.01%) of all real properties on the 1996-97 roll are under CLCA contract, representing 2,900 parcels out of 420,800 real property parcels. Agricultural reports continue to reflect a trend toward a reduction of the amount of acreage dedicated to fruit and nut production in Santa Clara County. In the event that economic trends change or other circumstances appear to indicate that the trees and / or vines under contract contribute significantly to the valuation process, we will revise our valuation methodology. It is simply not cost effective to do so given the current market environment.

### **RECOMMENDATION 4:**

*Properly assess all properties subject to the revisions of Article XVIII, Section 11 of the California Constitution.*

### **BACKGROUND:**

Taxable government-owned properties must be assessed in accordance with specific procedures required pursuant to the California State Constitution.

### **RESPONSE:**

Santa Clara County has 148 parcels that qualify as Section 11 properties. At the time of the SBE audit, 26 parcels remained incomplete for the 1996 roll. All 26 parcels have been valued and enrolled, and all Section 11 property assessments are complete at this time.

### **RECOMMENDATION 5:**

*Develop historical cost less depreciation and capitalized income value indicators for all private water companies and reappraise the transferred private Water Company.*

### **BACKGROUND:**

Generally there are two types of water companies which provide potable water service for their customer base within a specific geographic area; a "for profit" company regulated by the California Public Utilities Commission (PUC), and a private, not for profit, mutual water company.

### RESPONSE:

The County of Santa Clara currently has seven (7) "for profit" water companies. The Assessor utilizes the cost and income approaches when valuing such properties. The rate base as established by the PUC, is of considerable influence in the final determination of value. The Assessor will make annual written requests for CPUC reports on all "for profit" water companies in order to acquire the information necessary to make an accurate comparison of the current market value and the factored base year value.

The one very small "for profit" water company identified in the SBE survey, as having transferred ownership on December 15, 1994, has been reassessed and the values have been enrolled for the appropriate years.

### RECOMMENDATION 6:

*Improve the processing of business property statements by: (1) using the Board's equipment index and percent good factors as recommended in the AH 581; (2) applying the equipment index factors uniformly within similar business types; (3) screening the property statements for authorized signatures; and (4) purging old data from business property files.*

### BACKGROUND:

In Santa Clara County, 60,000 businesses file business property statements combining for a total of 90,000 assessments with a full cash value of \$19 billion dollars. To process this enormous volume in a short period of time, the office employs several computer systems to perform the requisite mathematical calculations for virtually all of the assessments.

### RESPONSE:

(1) The Assessor combines several SBE Index factors, where it can be demonstrated that minor differences in these factors will not have an appreciable affect on the resulting assessments within specific industries. When the current computer system reaches obsolescence, we will evaluate the financial feasibility of implementing this recommendation in developing our future cost capture system.

(2) We are continually evaluating and improving the process in which valuation factors are applied, including the issuance of written processing guidelines for the auditing staff. For the 1997-processing season, the description of each business class code was pre-printed on the front of the Business Property Statement, enhancing our ability to compare our information with the taxpayer's written description. This added processing feature facilitates more accurate and consistent valuations.

(3) Improvements have been made in our review procedures to identify unauthorized signatures in the signature block. Additionally, our correspondence with businesses, tax consultants and agents has emphasized filing and authorized signature requirements.

(4) We agree. Annually, old audits and documents are purged from the files, consistent with written guidelines. However, we have not been consistent in the application of these guidelines. We have recently re-emphasized the proper procedures with key staff personnel and are experiencing success in properly purging old data from our files.

#### **RECOMMENDATION 7:**

*Revise the assessment of personal property in apartments by: (1) basing the assessment on information provided on the apartment house property statements; and (2) correctly applying the low-value ordinance.*

#### **BACKGROUND:**

In an effort to streamline the process and enhance cost effectiveness, we established a direct billing program for apartment projects of sixteen to fifty units. Once the initial Apartment House Statement is filed, the enrolled value as of the lien date is carried forward for the next three years. New filings are not required in the interim. A letter is mailed in the intervening years to the apartment owners notifying them of the value of the personal property that will be included on the assessment notice.

Property statement forms are not mailed to apartment house owners with fifteen units or less. However, when an apartment house in this category changes ownership, the Real Property Division allocates the full market value between the land and improvements. For apartments with fifty-one or more units, an annual filing is required each lien date.

The Assessor concluded it is simply not cost effective to require apartment owners of apartment complexes less than 50 units to file business property statements every year. A four year billing cycle with the assessed value for 16 to 50 units which is automatically calculated in the intervening years, is an effective way to streamline the process, reducing the administrative burden and expense for both the Assessor and the taxpayers.

#### **RESPONSE:**

(1) The 1997 auditing staff's instructions for processing apartment house filings included the use of taxpayer's cost information. When the information is not provided, or is incomplete, the appraiser will apply reasonable estimates based on the number of units, and type of accommodations provided.

(2) In recognition of the low-value ordinance, where apartment complexes of fifteen units or less change ownership and the entire fair market value is allocated between the land and improvements, none of the value escapes assessment. Additionally, the low-value ordinance was increased from \$2,000 to \$5,000 by the County Board of Supervisors on May 5, 1998, effective for the fiscal year 1999-2000.



**RECOMMENDATION 8:**

*Revise the assessment of leasehold improvements by: (1) improving the positive response system to insure coordination between the business and real property divisions; and (2) ensuring that all leasehold improvements are treated uniformly.*

**BACKGROUND:**

Leasehold improvements are generally improvements made to a structure by the tenant, and are intended to facilitate the use of the real property in the economic pursuits of the tenant. In some cases, the leasehold improvements, although structure related, are in reality part of the manufacturing or business process. In other instances, the leasehold improvements are clearly a part of the structure and can be expected to have a life exceeding the manufacturing or business process.

**RESPONSE:**

(1) In Santa Clara County, we have several referral procedures for coordinating the assessment of leasehold improvements between the Business and Real Property Divisions. Periodic review and attention is given to the continued improvement of communication between the divisions. By the end of the year, the Department will be fully computer networked, offering new solutions to improve communication in this important area.

(2) The primary commercial / industrial economic base in Santa Clara County is related, either directly or indirectly, to the manufacture of computers, semiconductors, high tech defense equipment, and other electronic equipment. As such, the lives and turnover of the manufacturing equipment and related structural improvements tends, for the most part, to be related to the manufacturing process. Under these circumstances it may be appropriate to link those structural improvements to the life of the manufacturing process or possibly to the term of the lease.

**RECOMMENDATION 9:**

*Revise boat appraisal procedures by appraising pleasure boats at market value.*

**BACKGROUND:**

The 1996-97 roll included 8,400 boat assessments with a combined full cash value of \$54 million. It has been the practice to enroll a marine craft assessment at its original purchase price and then depreciate that value by 5% to 10% each year thereafter. The purchase price, either new or used, as stated in the survey questionnaire completed by the taxpayer, is checked against the published market guide. If the sales information is not provided, or the taxpayer questions our valuation, the published market guides are consulted to estimate or verify the accuracy of the enrolled value.

### RESPONSE:

Our current processing methodology appears to be effective in light of available resources and established priorities. However, we agree to contact other counties with market-based designed programs to determine whether their application procedures could benefit Santa Clara County.

### RECOMMENDATION 10:

*Revise the procedures for assessing computer programs by (1) assessing only basic operational programs; (2) establishing criteria for assessing computer software; and (3) explaining in the audit narrative and other workpapers the basis for assessing basic operational programs.*

### BACKGROUND:

In 1973, the Legislature enacted statutes that clarified the definition of computers for property tax purposes (R & T Code Sections 995 and 995.2). Section 995 directs the Assessor to value storage media for computer programs as if there were no computer programs on such media, except basic operational programs. Section 995.2 defines what is and what is not a basic operational program. Property Tax Rule 152 expanded upon the valuation of basic operational computer programs. In 1996 the SBE amended Rule 152, in part, by narrowing the definition of a basic operational program.

### RESPONSE:

The amended rule 152 took effect November 3, 1996. Although we believe that the amended Rule conflicts with Sections 995 and 995.2, we instructed the audit staff to discontinue assessing computer software, both operational and application software. Furthermore, prior to the commencement of the 1997 audit season, the staff was directed not to assess basic operational software when discovered during the audit process. On April 25, 1998, written instructions were distributed reiterating the new policy.

With respect to the two accounts where we inadvertently assessed software, corrections will be made. Fortunately, this oversight involved less than 2% of the total value of either account.